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No. 71-804

In the

Supreme Court of the United States

OCTOBER TERM, 1971

GABRIEL WOLFF,

Petitioner,

vs.

HERBERT F. KORHOLZ, MARTHA KORHOLZ and THE SUSQUEHANNA CORPORATION,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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IN THE

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HERBERT F. KORHOLZ, MARTHA KORHOLZ and THE SUSQUEHANNA CORPORATION,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Gabriel Wolff prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit dated September 21, 1971.

OPINIONS BELOW

The United States District Court for the Northern District of Illinois entered no opinion and rendered its decision on June 10, 1969.

The opinion of the United States Court of Appeals is reported at 449 F.2d 82, (7th Cir. 1971) and appears at A.1.[1]

[1] References to the Appendix are noted as "A" followed by the page number and references to the Record are noted in similar manner using the abbreviation "R." References to plaintiffs' and defendants' exhibits are respectively designated as "PX" or "DX" followed by the number.

JURISDICTION

The decision of the Court of Appeals was dated September 21, 1971 and rehearing was not requested.

Certiorari jurisdiction is invoked pursuant to the provisions of 28 U.S.C. §1254 (1).

QUESTIONS PRESENTED

1. Whether in a §16(b) case in determining the purchase price of 430,000 shares of stock obtained by an insider in a "short swing" transaction, the quotation price for 100 share lots as determined by reference to the "bids" and "asks" in the over-the-counter market on a particular date have any probative value for determining the value of in excess of 1 million shares.

2. Whether in a §16(b) case in determining the purchase price of 430,000 shares of stock obtained by an insider in a "short swing" transaction, an *average* of the "bids" and "asks" quotations in the over-the-counter market on a particular date may be used.

3. Whether in a §16(b) case the purchase price of 430,000 shares of stock obtained by an insider on a particular date in a "short swing" transaction may be determined by reference solely to the over-the-counter market "bids" and "asks" on a particular date without regard to the appraisals of those shares made by admittedly well qualified experts for purposes of a corporate marger which gave rise to the purchase of which complaint was made.

4. In a §16(b) case is market value the sole criteria of the value of shares of stock when determining the profit occasioned in a "short swing" transaction.

5. May a controlling stockholder who in a merger receives the same price per share as all minority stockholders

attach for §16(b) purposes an arbitrary and unrealized value to his shares as a control premium in order to avoid §16(b) liability which existed without such addition.

STATUTES INVOLVED

Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78p(b)) reads as follows:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased of or not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

STATEMENT OF THE CASE

Petitioner Gabriel Wolff, a stockholder of The Susquehanna Corporation ("Susquehanna"), filed a derivative complaint based upon §16(b) of the Securities Exchange Act of 1934 on behalf of Susquehanna against Herbert F. Korholz ("Korholz") and his wife. Federal jurisdiction was based upon §27 of the Securities Exchange Act of 1934 (15 U.S.C. §78aa). The gravamen of the action was (i) that Korholz was a director and a beneficial owner of in excess of 10% of the capital stock of Susquehanna and controlled Susquehanna, (ii) Korholz sold 430,000 Susquehanna shares to American Gypsum Company ("Gypsum"), another corporation which he controlled, for approximately $6,500,000 or $15.11 per share, (iii) within six months thereafter, Korholz caused Gypsum to be merged into Susquehanna, the merger being based upon an evaluation of $10.75 per Susquehanna share and $5.65 per Gypsum share, whereby Korholz purchased in excess of 430,000 Susquehanna shares, and (iv) the foregoing occasioned a "short swing" profit of approximately $4.36 per share, all in violation of §16(b) of the Securities Exchange Act of 1934.

At trial petitioner relied entirely upon documents consisting of, among others, reports to the Securities and Exchange Commission made by Korholz as required by §16(a) of the Securities Exchange Act (15 U.S.C. §78p(a)) reflecting sales and purchases of the Susquehanna shares by him, documents obtained from Susquehanna evidencing the sale and merger of Gypsum into Susquehanna which gave rise to the purchase, and reports to the Securities and Exchange Commission by Gypsum and Susquehanna in which the purchase and sale were reflected.

On the question as to whether Korholz realized a §16(b) profit, petitioner relied upon appraisals of the business and

shares of Gypsum and Susquehanna made by New York Hanseatic Corporation and Stone & Webster Service Corporation at the request of Korholz for use in connection with his merger of Gypsum into Susquehanna. These appraisals valued Gypsum shares at $5.65 and Susquehanna shares at $10.75 and resulted in a 1.9 to 1 merger ratio of Gypsum to Susquehanna shares. Since Korholz had sold Susquehanna shares at $15.11 per share and purchased shares at $10.75 within a six month period at a profit it was alleged that a "short swing" profit was made by Korholz and for which recovery was sought in an amount in excess of $1,600,000.

The trial court, ignoring the New York Hanseatic and Stone & Weber appraisals, decided the "profit realized" question adversely to the petitioner. In this connection the lower court found that (i) on December 13, 1965, (the effective date of the merger of Gypsum into Susquehanna) the average of the "bid" and "ask" quotations in the over-the-counter market for Gypsum shares was approximately $6.875, (ii) since Korholz controlled Gypsum, there should be added to the value of his shares a premium of 20%, and (iii) the merger ratio was 1.9 Gypsum shares for each Susquehanna share. Based upon the foregoing, the trial court concluded that a Susquehanna share was worth in excess of $15.11 and therefore Korholz made no "short swing" profit, the price at which Korholz had sold Susquehanna shares.

Upon appeal, the court below assumed that petitioner had made out a case as to a sale and a purchase by Korholz of his Susquehanna shares sufficient to establish §16(b) liability. However, it approved and accepted the trial court's use of the "average" ($6.875) of the "bids" and "asks" in the over-the-counter market of the Gypsum shares on December 13, 1965 and its addition of a control

premium of 20% to that average. Under the formula, the Court of Appeals found that Korholz made no profit on the "short swing" transaction. The court at footnote 3 (A. 6) in apparent rejection of the appraisals found that the appraised values were not market values and stated:

> "On the other hand, the $5.65 per share value of Gypsum was the 'going concern' value based upon the experts' analysis of earnings, appropriate capitalization rate and other factors. These figures were not intended to represent the market price in August, 1965, or at any other time. As far as market value is concerned, the figure could at best be characterized as the experts' view on what the market price *should* be. It *would* be such only if all investors shared the experts' interpretaion of each of the many divergent factors affecting market value."

Thus the lower court's decision was affirmed.

REASONS FOR GRANTING THE WRIT

Each of the Questions Presented has been answered in the affirmative in the court below.[2] Those answers are in derogation of the purpose for which §16(b) was enacted, will defeat its enforcement and are in conflict with many decisions of other Circuits, as is now shown.

I. Conceding, Arguendo, That Over-The-Counter Quotations Have Any Probative Value in the First Place, Use Of An "Average" Quote When Calculating "Short Swing" Profits Seriously Undermines the Legislative Purpose of Section 16(b) and Is In Conflict With Decisions in Other Circuits.

The Court of Appeals approved of the trial court's use of the "average"[3] price of Gypsum shares in the over-the-counter market on December 13, 1965 (the effective date of the merger and thus the date of purchase by Korholz of his Susquehanna stock) as the base from which profits were to be calculated. In so doing the Court of Appeals not only seriously undermined the legislative purpose of §16(b) but departed from precedent.

The purpose of §16(b) is set forth in *Feder* v. *Martin Marietta*, 406 F.2d 260 (2nd Cir. 1969) at p. 262:

> "The purpose of §16(b) as succinctly expressed in the statute itself is to prevent unfair use of information by insiders and thereby to protect the public and outside stockholders. The only remedy which the framers of §16(b) deemed effective to curb insider abuse of advance information was the imposition of a liability based upon an *objective measure of proof*, e.g.,

---

[2] A negative answer to any one of them would have resulted in "profit realized" under §16(b).

[3] The term average is in quotes since Korholz's witnesses each employed a different combination of a "bid" and "ask" quotation to obtain the value of Gypsum's shares in the over-the-counter market.

Smolowe v. *Delendo Corp.*, 136 F.2d 231, 235 (2nd Cir.), *cert. denied*, 320 U.S. 751 (1943). *Thus, application of the act is not conditioned upon proof of an insider's intent to profit from unfair use of information*, e.g., *Blau* v. *Lamb*, 363 F. 2d 507, 515 (2nd Cir., 1966), *cert. denied*, 385 U.S. 1002 (1967), *nor upon proof that the insider was privy to any confidential information*, e.g., *Ferraiolo* v. *Newman*, 259 F.2d 342, 344 (6th Cir., 1958), *cert. denied*, 359 U.S. 927 (1959). *Rather, §16(b) liability is automatic, and liability attaches to any profit by an insider on any short-swing transaction embraced within the arbitrarily fixed time limits of the statute.*" (Emphasis added.)

See also *Bershad* v. *McDonough*, 428 F.2d 693, 696 (7th Cir. 1970); *Magida* v. *Continental Can Co.*, 231 F.2d 843, 846 (2nd Cir. 1956); *Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 237-39 (2nd Cir. 1943); *Blau* v. *Max Factor*, 342 F.2d 304, 307-308 (9th Cir. 1965); *Park and Tilford, Inc.* v. *Schulte*, 160 F.2d 984 (2nd Cir. 1947); *Western Auto Supply Co.* v. *Gamble Skogmo, Inc.*, 348 F.2d 736 (8th Cir. 1965); and *Volk* v. *Zlotoff*, 285 F.Supp. 650, 654-56 (S.D.N.Y. 1968).

Thus in essence §16(b) reflected the exchange of certainty of imposition of liability without proof of intent to take advantage of or even knowledge of inside information by the insider for certainty of non-imposition of liability if the arbitrary but known limitations contained in §16(b) were observed. This section of the statute was highly remedial and although at times harsh, was the remedy thought to be the most effective to combat flagrant abuse of insider information. See S.Rep. No. 1455, 73rd Cong., 2nd Sess. 55 (1934) as repeated in many opinions, e.g., *Volk* v. *Zlotoff*, *supra* at ftn. 2.

In conformance with the remedial purpose of §16(b) it was early determined that when any reasonable choice was available, one imposing liability or maximizing profit and

the other not imposing liability or minimizing profits, the former choice has always been taken. *Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 235 (2nd Cir. 1943); *Gratz* v. *Claughton*, 187 F.2d 46 (2nd Cir. 1951); *Booth* v. *Varian Associates*, 334 F.2d 1 (1st Cir. 1964) ("... purchase date within recovery period should be selected . . ."), and *Ferraiolo* v. *Newman*, 259 F.2d 342, 345 (6th Cir. 1958). See also discussion in *Blau* v. *Oppenheim*, CCH Fed. Sec. L. Rep. ¶91,630 (S.D.N.Y. 1966) Transfer Binder, '64-'66 Decisions.

As a result of the foregoing whenever the use of an "average" price was suggested as the manner in which stock was to be evaluated, it was rejected on the basis of *Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 239 (2nd Cir. 1943). The *Smolowe* doctrine requires that in §16(b) cases the courts are obliged to squeeze out all possible profits so as to prevent the breaches of fiduciary duty by the insider and thus effectuate the remedial concepts embodied in that section. As examples of the rejection of averaging in the context of §16(b), see *Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 239 (2nd Cir. 1943); *Marquette Cement Mfg. Co.* v. *Andreas*, 239 F.Supp. 962, 968 (S.D.N.Y. 1965); *Heli-Coil Corporation* v. *Webster*, 222 F.Supp. 831, 837 (D.C.N.J. 1963), modified 352 F.2d 156, 171 (3rd Cir. 1965); *Blau* v. *Lamb*, 242 F.Supp. 151, 160-61, 163 (S.D.N.Y. 1965) (specifically rejecting the use of an average price and citing *Marquette Cement* v. *Andreas*), aff'd. in part, rev'd in part, 363 F.2d 507 (2nd Cir. 1966); and *Blau* v. *Lehman*, 173 F.Supp. 590, 595 at ftn. 3 (S.D.N.Y. 1959), aff'd. 286 F.2d 786 (2nd Cir. 1960), aff'd 368 U.S. 403 (1962).

The use by the Court of Appeals and the lower court of the average in the over-the-counter market of the high "bid" and low "ask" is completely in conflict with these decisions and contrary to the purposes of §16(b). This is especially so in view of the reasonable choices available as an alternative to "averaging," i.e. the merger appraisal of

$5.65 for each Gypsum share, the low bid on December 13, 1965 of $6.00 for each Gypsum share and proof of purchases by Gypsm of 206,000 shares of Gypsum stock in the over-the-counter market for a price of approximately $5.82 per share during pertinent times. (DX 13, Item 14).

II. The Application of a 20% Control Premium Not Only Was Improper in the Context of This Case But Serves To Add Uncertainty and Expense of Enforcement to An Area of Law Which Is Dependent Upon Certainty and Ease of Enforceability.

If in the context of a statutory merger and a merger agreement explicitly providing that all stockholders were to be treated equally, the insider can successfully assert that his block of stock is worth a premium, the battle of experts in the area of §16(b) litigation has begun and ease and certainty of enforcement by small shareholders has ended. In the case of a §16(b) violation by a controlling stockholder, the action by stockholders is the only effective remedy and this remedy is much blunted by the knowledge that he is entering on a battlefield in which experts are able to argue as to the percentage to be added as a premium for control.

The matter of the payment of premiums for control is becoming more and more a matter of concern and of tremendous importance to vast numbers of minority shareholders. Many views are expressed as to their rights under such circumstances. Letts, Sales of Control Stock and Rights of Minority Shareholders, 26 Business Lawyer 631 (January, 1971). The decision below not only gives carte blanche approval to the payment of such premiums but does this under the most absurd circumstances in a situation where the element of control was not even a factor. All shareholders were treated alike in the merger of Gypsum into Susquehanna.

It is also absurd to apply a premium for control in a situation involving a merger of two corporations, both of which are controlled by the insider prior to the merger and the surviving corporation being controlled after the merger. It was not disputed at trial that a premium for control is paid only when demanded by a seller and Korholz being in control of Susquehanna and Gypsum neither demanded from nor paid such a premium to himself.

Further, although all stockholders were treated equally by the merger agreement, if the block of shares owned by Korholz were deemed to have a greater value, then another block of shares in the same merger, the minority, has a lesser value. This illustrates the impropriety of the use of control premiums in the context of merger.

The evasion of §16(b) liabilities by permitting such ephemeral evaluation based on non-existent facts can only result in eroding the enforcement of §16(b).

III. The Use of Hypothetical Valuations When Determining §16(b) Profits Rather Than The Valuations Agreed Upon By the Parties As The Basis of the Purchase Impedes Enforcement of §16(b) Liability.

Although the appraisals by New York Hanseatic Corporation and Stone & Webster Service Corporation valuing Gypsum and Susquehanna at $5.65 and $10.75, respectively, served as the basis for the terms of the merger of Gypsum into Susquehanna as approved by Korholz, the lower courts relied upon a hypothetical market value as modified by a hypothetical premium for control so as to eliminate all "short swing" profits. Possibly resort to hypothetical values as determined by experts is necessary in the absence of the setting of a price by the parties to the short swing transaction of which complaint is made. However, in the face of a valuation agreed upon the use of hypothetical values merely furnishes the insider with another chance

to employ expensive experts to prove after the fact that the prior evaluations given by him to shares sold were incorrect.

This approach to creative evaluation is contrary to the Second Circuit's decision in *Stella* v. *Graham-Paige,* 259 F.2d 476 (2nd Cir. 1958) wherein at p. 478 it is stated:

> "Many factors enter into value. The weight to be given to these factors involves the business judgment of the bargaining parties. In the absence of fraud or self-interest, the judgments of corporate directors representing KF and GP are not lightly to be disregarded. As the threshold of the transaction the directors of KF had to determine the price to be paid for the GP assets. If KF, instead of issuing 750,000 shares of stock to GP, had paid $7,500,000 for the assets transferred because of the special and unique value which they had to KF, this dollar amount would have represented to KF and GP the value of the assets."

To permit such reevaluations would completely emasculate enforcement of §16(b). Every insider could claim that although he purchased shares at $1, the real value was $2 and thus no short swing profit or liability was incurred.

Section 16(b) proscribes to the insider ". . . any *profit realized* by him from any purchase and sale . . ." (emphasis supplied). The distinction between profit realized (the concept condemned by §16(b)) and value as employed by the Court of Appeals must be made. If in the actual transaction which gives rise to the §16(b) purchase or sale there is agreement as to price (or as in this case independent appraisers set the price) upon which the transaction is based and that price is received, then other prices or other valuations are irrelevant. Here Korholz hired appraisers, approved of their evaluations and based the "purchase" of the Susquehanna shares upon these evalu-

ations. If the appraisers were later found to be in error and Gypsum was worth $10 per share—of what relevancy is that fact since Korholz has already accepted $5.65 and if he made a profit that sum was fixed by the evaluation of $5.65. By similar analysis, no matter how valuable, the "sale" by gift of appreciated securities does not give rise to §16(b) profits. *Shaw* v. *Dreyfus*, 172 F.2d 140 (2nd Cir. 1949) and *Truncale* v. *Blumberg*, 80 F.Supp. 387 (S.D.N.Y. 1948) aff'd, 182 F.2d 1021 (2nd Cir. 1950).

IV. The Use of Over-The- Counter Quotations To Establish Valuation of Korholz's Holding of 56% of Gypsum is Illogical and Contrary to Decisions of Other Courts.

Acknowledging that there were no actual trades of Gypsum stock on December 13, 1965 and that over-the-counter quotations are based upon 100 share lots (A. 9, 10), the Court of Appeals nevertheless accepted these quotations as the base from which Korholz's over 1,000,000 shares of Gypsum were valued.[3] The exhaltation of the over-the-counter quotations is unprecedented in §16(b) litigation and contrary to two recent lower court opinions.

The true nature of the over-the-counter quotations was recently discussed in *Kramer* v. *Ayer*, 317 F.Supp. 254 (S.D.N.Y. 1970). The Court said at p. 260:

> "More importantly, and as already indicated, throughout his argument plaintiff consistently confuses bid and asked quotations with market prices and uses these terms interchangeably, ignoring thereby the essential differences which exist between bid and asked quotations and market prices. Bid and asked quotations are not market prices. They do not represent actual transactions whereas market prices are derived only from actual sales of shares of stock.

[3] Korholz and his wife owned in excess of 1,000,000 Gypsum shares for which they received approximately 526,700 Susquehanna shares.

> At the very best bid and asked quotations are nothing more than offers to buy and offers to sell. And sometimes these offers to buy and to sell are not firm so that very often it cannot even be said that a stock necessarily can be sold at the bid figure to be bought at the asking figure. These facts are not unknown to market participants; the court can only guess at why plaintiff has confused the issue in the manner that he has. Indeed, at the bottom of the very report of the National Quotations Bureau submitted by plaintiff it says that 'The above quotations represent prices between dealers and do not include retail mark-up, mark-down or commission. They do not represent actual transactions, and have not been adjusted for stock dividends or splits.'"

Parenthetically, the National Quotation sheets relied upon by Korholz to establish the over-the-counter market quotations contained the same restrictive legend. (See DX 118, 120).

In *Franklin National Bank* v. *L. B. Meadows & Company,* 318 F.Supp. 1339 (E.D.N.Y. 1970), the court stated, pp. 1341, 1343:

> "'Pink sheets' are published daily by National Quotation Bureau, Inc.; they are formally known as the National Daily Quotation Service. Subscribers include broker-dealers as well as various banks. The former, known as listing subscribers, place bid (will buy at) and ask (will sell at) quotations in the 'pink sheets' for various over-the-counter securities. These are offers and do not reflect completed transactions. When doing this for one stock over a period of time, the broker-dealer is said to be 'making a market' in that security. See L. Loll and J. Buckley, The Over-The-Counter Securities Markets 146 (2d ed. 1967). Each quotation in the 'pink sheets' obligates the broker-dealer to a one-hundred share transaction at the stated price. Any larger sale is a matter for negotiations. See generally L. Loss, Securities Regulation 3318-27 (2d ed. 1961); Burns, Over-The-Counter

Market Quotations: Pink Yellow, Green and White Sheets—A Gray Area in the Law of Evidence, 52 Cornell L.Q. 262 (1967)."

• • •

"Broker-dealers also trade in great numbers and varieties of securities. L. Loll and J. Buckley, The Over-The-Counter Securities Markets 142-143 (2d ed. 1967). Some commentators have claimed that 'pink sheets' too often include 'illusory, misleading, and fictitious quotations.' Burns, Over-The-Counter Market Quotations: Pink, Yellow, Green and White Sheets—A Gray Area in the Law of Evidence, 52 Cornell L.Q. 262, 268 (1967."

To employ these quotations which are rather inaccurate as applied to 100 share lots as a base from which by mere multiplication to value 1 million shares serves to magnify the error so that the result is legally unacceptable.

CONCLUSION

This Court should issue its Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit to review its opinion dated September 21, 1971.

Respectfully submitted,

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APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

SEPTEMBER TERM, 1970—APRIL SESSION, 1971

No. 18053
PAUL MUELLER and GABRIEL WOLFF,
Plaintiffs-Appellants,
v.
HERBERT F. KORHOLZ, MARTHA KORHOLZ and THE SUSQUEHANNA CORPORATION,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

SEPTEMBER 21, 1971

Before KILEY, FAIRCHILD and STEVENS, *Circuit Judges.*

STEVENS, *Circuit Judge.* Plaintiff-appellant, a shareholder of Susquehanna Corporation, contends that the second and third steps of a three-step transaction produced a "short-swing" profit for defendant Korholz, a Susquehanna director, which is recoverable on behalf of Susquehanna pursuant to § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). Defendants contend that the second step was not a "sale" within the meaning of the Act and, in any event, there was no "profit realized by" Korholz from either the entire transaction or just the last two steps.

After a full trial, the district court made extensive findings of fact sustaining these defenses. In our opinion the findings that Korholz realized no profit are well supported by the record and, therefore, we do not reach the issues raised by the first defense. Nevertheless, a description of the entire transaction is essential to an understanding of the case.

I.

The three steps took place on May 25, July 2, and December 13, 1965.

A. On May 25, 1965, Korholz acquired 430,000 shares of Susquehanna common stock at a price of $15 per share. Before making this acquisition Korholz had reached at least an informal understanding with four other interested parties.

1. The sellers (referred to as the "Lannan Group") advised Korholz early in May that their Susquehanna stock was available for purchase at a price of $15 per share, payable in cash, provided that the transaction could be closed promptly. Since they were to be paid in cash the Lannan Group was apparently willing to sell either to Korholz individually or to American Gypsum Company (Gypsum). Korholz was a director of Gypsum and with his family owned 56% of its stock.

2. The First National Bank of Boston ("the Bank") agreed to lend $6,500,000 to Gypsum to finance the purchase provided that it could be assured of a first lien upon Gypsum's assets as well as a pledge of the Susquehanna shares to be purchased. The condition could not be satisfied by Gypsum without the consent of two insurance companies from which it had borrowed substantial funds in March. After the insurance companies indicated their willingness to consent on certain conditions, and after Korholz and Gypsum indicated that the conditions could be met, the Bank agreed to make an interim loan to Korholz individually, which would be replaced within 30 days by a loan to Gypsum. Before any funds were

disbursed in consideration of the note signed by Korholz personally, the Bank had received the substitute note and other documents executed by Gypsum, as well as telegraphic confirmation of the insurance companies' informal consent.

3. The two insurance companies agreed to consent to the bank loan secured by a first lien on Gypsum's assets on three conditions:

(a) that Gypsum would agree to repay the bank loan upon a merger of Gypsum into Susquehanna;

(b) that the proceeds of any sale of Gypsum's Albuquerque plant be used to reduce the bank loan; and

(c) that Korholz and two other Gypsum directors be elected to Susquehanna's board.

In telegrams sent to Gypsum on May 12 and May 14, the insurance companies evidenced their consents subject to these specific conditions.

4. The Gypsum board of directors decided at a meeting on May 12, 1965, to acquire the Susquehanna shares for the price specified by the Lannan Group; to make the bank loan; and to accept the conditions requested by the insurance companies. Since the Bank was unwilling to advance funds to Gypsum until after its loan agreements with the insurance companies had been formally amended to evidence their consents, and since the Lannan offer would expire before the amendments could be drafted, approved and executed, the Gypsum board adopted a resolution providing that if Korholz acquired the stock individually, and if the consents were obtained within one month, Gypsum would acquire the stock from Korholz at his exact cost.[1]

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[1] The directors' resolution read, in part:

"WHEREAS, it is the consensus of this Board that it would be in the best interest of this company to acquire the aforesaid shares of Susquehanna at said price and but for the necessity of obtaining the con-

The resolution specified that Gypsum would be under no obligation to Korholz if the consents were not received within one month.

As contemplated by the May 12 resolution of the Gypsum board, and by the informal understanding with the Bank and the insurance companies, Korholz purchased the Susquehanna shares on May 25, 1965. The transaction was closed through an escrow. As noted, before the funds were disbursed the escrow deposits were made not only by the sellers and Korholz, but also by Gypsum which had executed an undated note and other documents contemplating a transfer of the transaction to it as soon as the documentation was concluded. The purchased Susquehanna shares were issued in the name of a nominee and held by the Bank, originally as security for Korholz's note and later for Gypsum's.

If the scriveners had completed their work before June 12, 1965, the conditions specified in the directors' resolu-

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[1] (Continued)

sent of insurance companies to which this company is indebted to waive restrictions under certain note agreements, this Board would adopt a resolution authorizing the purchase of said shares of Susquehanna at that price; and

"WHEREAS, it is the desire of this Board to place the company in a position to acquire said shares contingent upon the consent of insurance companies; and

"WHEREAS, Herbert F. Korholz and Martha Korholz have indicated their willingness to attempt to acquire said shares as their own property at a price of $15.00 per share, and to bind themselves to sell said shares, if acquired, to the company at that price if and when impediments to acquisition by the company are removed, and this company has indicated to Herbert F. Korholz and Martha Korholz that it will acquire from them said shares for a price equal to the price paid by them, together with costs and expenses . . . incident to said acquisition, if the insurance companies . . . agree to the modification of the Indenture Agreements enabling this company to acquire said shares;

tion would have been performed to the letter and this litigation would never have arisen.

B. On July 2, 1965, Gypsum acquired the 430,000 shares of Susquehanna stock from Korholz for $6,499,028.96, equivalent to a price of $15.114 per share. The amount was equal to the price paid to the Lannan Group, plus interest on the interim loan and other costs attributable to the transaction.

The formal amendments to the agreements with the insurance companies were executed "as of" June 9, 1965, but their execution and delivery was not actually completed until after June 12, 1965. The legal consequences of the failure to meet the deadline are the subject of extensive factual and legal argument, but for purposes of our decision we make the somewhat theoretical assumption that between June 12 and July 2 Korholz had the legal right to act as sole owner of the Susquehanna

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[1] (Continued)

"NOW, THEREFORE, BE IT RESOLVED: That if Herbert F. Korholz and Martha Korholz acquire 430,000 shares of Susquehanna at $15.00 per share and if consents are first had and received from the insurance companies to which this company is indebted under certain loan indentures permitting acquisition of said shares, the company will acquire from Herbert F. Korholz and Martha Korholz said approximately 430,000 shares of the common stock of The Susquehanna Corporation at $15.00 per share, together with reimbursement to Herbert F. Korholz and Martha Korholz of any costs and expenses (including any interest expense incurred by them) incident to said acquisition; provided that such consents are received within one month from the date of this resolution. If such consents are not received, the company shall be under no obligation to Herbert F. Korholz and Martha Korholz in connection with their acquisition of said shares. If Herbert F. Korholz and Martha Korholz do not acquire said shares, they shall be under no obligation to the company in connection thereunder."

stock. On this assumption, he sold it to Gypsum on July 2, 1965.

C. On December 13, 1965, Gypsum was merged into Susquehanna. For each 1.9 shares of Gypsum stock, Korholz and his wife, like all other Gypsum shareholders, received one Susquehanna share. In exchange for their block of Gypsum, they acquired over 430,000 shares of Susquehanna.[2] Thus, less than six months after his "sale" of Susquehanna to Gypsum on July 2, 1965, Korholz made a "purchase" of a larger block by reason of the merger.

The experts who were employed to recommend an exchange ratio made an appraisal of the value of each company's shares in August, 1965. The 1.9 to 1 exchange ratio reflected appraised values of $10.75 and $5.65 per share of Susquehanna and Gypsum, respectively. On the basis of these appraised values, plaintiff contended that Korholz had paid a price of $10.75 per share for the Susquehanna stock acquired by the merger. He thus allegedly realized a profit of $4.364 per share, representing the difference between $10.75 and the price of $15.114 received on July 2, 1965.[3]

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[2] Korholz received 386,102; Mrs. Korholz received 140,171.

[3] Plaintiff omits mention of the fact that appraisal values determined for reorganization purposes are not market values. Susquehanna's $10.75 per share value was the so-called "break up" value determined by valuing all of Susquehanna's assets and dividing the total by the number of outstanding shares. On the other hand, the $5.65 per share value of Gypsum was the "going concern" value based upon the experts' analysis of earnings, appropriate capitalization rate and other factors. These figures were not intended to represent the market price in August, 1965, or at any other time. As far as market value is concerned, the figure could at best be characterized as the experts' view on what the market price *should* be. It *would* be such only if all investors shared the experts' interpretation of each of the many divergent factors affecting market value.

Alternatively, on appeal plaintiff makes two additional arguments. First, noting that over-the-counter quotations immediately prior to the merger were about $13.00 for Susquehanna and about $7.00 for Gypsum, he contends that current market values established a profit of $2.00 per share. Second, he contends that the burden of disproving a profit should have been placed on Korholz as a fiduciary who had breached his trust to Susquehanna shareholders by engaging in a "short-swing" transaction.

The district court found that Korholz had made no profit. Instead of concentrating attention on the value of the Susquehanna shares received by Korholz as a result of the merger, the court focused on the value of the consideration which Korholz exchanged for that stock. That consideration, he found, was a control block of Gypsum stock which had a value greater than the market value of individual Gypsum shares. Based on expert testimony offered by defendants, the court found that the value of the consideration surrendered by Korholz on December 13, 1965, was in excess of $15.11 for each share of Susquehanna stock received. On the basis of these findings of fact, Korholz derived no profit from the transaction.

II.

We first consider plaintiff's final argument relating to burden of proof. The short answer to this argument is that defendant did assume the burden of proving that he paid more for the Susquehanna shares that he acquired in December than he had received for those he sold in July. The district court found that this evidence was reliable and sufficient and sustained that burden.

In addition, we note that plaintiff's entire case is predicated on acceptance of a truncated version of the transaction as including only steps two and three. If we view the transaction as a whole, it is plain that Korholz gained nothing but the benefits of the merger itself. As originally intended, and as ultimately consummated, his participation in steps one and two was entirely for the

benefit of Gypsum and its stockholders.[4] There is not the slightest evidence of overreaching or lack of good faith. In contrast to the facts disclosed in typical cases imposing a severe burden of justification on a faithless fiduciary,[5] if liability attaches here, it will result not from the character of the business behavior, but solely from counsel's failure to structure the transaction in a somewhat different form or to conclude necessary documentation more promptly. Nevertheless we accept plaintiff's truncated version of the transaction for purposes of our decision.

III.

The price of $15.114 per share received by Korholz on July 2, 1965, was a derived price, computed by dividing the aggregate amount of his reimbursement ($6,499,028.96) by the number of shares in the block (430,000). The "price" which Korholz paid for the block of Susquehanna shares received on December 13, 1965, is necessarily also a derived price, which must be computed by dividing the value of the consideration which he surrendered by the number of Susquehanna shares he received. See *Stella* v. *Graham-Paige Motors Corp.*, 259 F.2d 476, 479 (2nd Cir. 1958), *cert. denied*, 359 U.S. 914; *Blau* v. *Mission Corp.*, 212 F.2d 77, 81 (2nd Cir. 1954), *cert. denied*, 347 U.S. 1016. Contrary to plaintiff's argument, the value of the Susquehanna shares which Korholz received, whether measured by the appraisals in August or by the market value in December, is not of controlling importance.

As consideration for the Susquehanna shares acquired on December 13, Korholz parted with a block of Gypsum stock which represented control of that company. Two

[4] Indeed, the predicate for plaintiff's entire statutory case is a denial of a continuing fiduciary relationship between June 12 and July 2, 1965.

[5] *Pepper* v. *Litton*, 308 U.S. 295, 306; *Geddes* v. *Anaconda Copper Mining Co.*, 254 U.S. 590, 599; *Shlensky* v. *South Parkway Building Corp.*, 19 Ill.2d 268, 280-81, 166 N.E. 2d 793, 800-01 (1960).

well qualified experts[6] testified that such a block has a greater value per share than individual shares. The trial court credited this testimony and we do not understand plaintiff to dispute this basic proposition. *Cf., Essex Universal Corp.* v. *Yates*, 305 F.2d 572, 576 (2nd Cir. 1962); *Royal Trust Co.* v. *Equitable Life Assur. Society*, 247 F. 437, 441 (2nd Cir. 1917). However, plaintiff does attack the experts' calculation of the premium value of Korholz's Gypsum stock.

The trial court found that the average price of Gypsum stock in the over-the-counter market on December 13, 1965, was $6.875 per share. It then found that shares in a control block had an additional, or premium value of 20%. Using that premium value ($8.25), the exchange ratio of 1.9 to 1 resulted in a derived price of $15.675 for the Susquehanna shares acquired by Korholz on December 13. Since this price was higher than the derived price of $[illegible]4 received in July, Korholz realized no profit.

Plaintiff attacks the premise that $6.875 represented the value of Gypsum stock on December 13, and also the finding that Korholz's control block was worth a premium of 20%. We think both findings are supported by the evidence.

On December 13 there was no actual trade of Gypsum stock. Quotations in the over-the-counter market ranged on the "bid" side from 6-¾ to 6, and on the "asked" side from 7-¼ to 7-⅛.[7] The court, using a point above the high bid and below the lowest asking price, concluded that

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[6] Robert A. Podesta, President, The Chicago Corporation, and Robert M. Leopold, a Vice President of New York Hanseatic Corporation.

[7] One of the exhibits shows an asking price of only 6-½, but this was a report which had been received in the mail and reflected the market at an earlier time; both expert witnesses agreed that that figure should be disregarded.

the value was 6-⅞.* The expert testimony describing the over-the-counter market in Gypsum itself over a period of time clearly supports this finding as a reasonable interpretation of the facts.

Plaintiff makes three objections to the finding that Gypsum shares were worth $6.875 on December 13. First he contends as a matter of law that the low bid price of $6.00 was the only acceptable evidence of value because the policy of § 16(b) requires the court to adopt an interpretation of the facts that will "squeeze out all possible profit." *Cf. Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 239 (2nd Cir. 1943).

The comment in that case may guide a court's choice between two reasonable interpretations of the facts. It does not require a court to adopt a completely unrealistic interpretation of the market. In this case the evidence shows that the owners of Gypsum were unwilling to sell for less than $7.125 a share and prospective purchasers were willing to pay $6.75. Clearly a finding that the market value was only $6.00 would be unsupportable.

Second, plaintiff contends that nothing short of an actual trade can evidence market value on a given day. The testimony of the experts was to the contrary, and we agree with the district court that it was credible. There is ample precedent for this view. See *Jaffe* v. *Cuthbertson*, 412 Ill. 606, 615-16, 107 N.E.2d 715, 721 (1952); *Allender & Co.*, 9 S.E.C. 1043, 1057-58 (1941); *Charles Hughes & Co.*, 13 S.E.C. 676, 678-79 (1943).

Third, plaintiff correctly points out that the market quotations are for 100 share lots and do not establish the value of a block of several hundred thousand shares.

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* Decimally, the median price would have been approximately $6.93, but expert witness Leopold apparently rounded off to a fraction and estimated the value at 6-⅞. Expert Podesta testified to a value of 6.93 which he rounded to 6.90. The trial judge, by using the 6-⅞ figure, stated decimally as $6.875, thus took the figure most favorable to plaintiff.

Such a quantity of stock offered for sale on the open market might well drive the price down precipitously. But no such "dumping" took place or was contemplated. The experts made no attempt to estimate the price that would be realized in such a hypothetical situation. They merely used the market quotations as one element in their calculation of the value of Korholz's stock. Their opinion that his holdings had a greater value than smaller lots was supported not only by their expert judgment but also by the fact that he received a premium offer not long before the merger.[9] We think the evidence amply supports the finding of $6.875 as an "average price" or value of Gypsum stock on December 13, 1965.

Plaintiff also attacks the finding that Korholz's shares had a premium value of 20%. First, he argues that a premium may only be recognized in the context of a negotiated transaction, and that Korholz's position as a fiduciary foreclosed him from seeking more favorable benefits from the merger than other Gypsum stockholders.[10] The argument loses sight of the fact that the valuation issue turns not on the value of what Korholz might receive, but rather on the value of what he delievered. Whether he did or could negotiate a favorable bargain is beside the point. Our only concern is with the value of the Gypsum block which he surrendered. The finding that those shares had a premium value is well supported by the record.

Second, plaintiff contends that the amount of 20% is excessive. One expert estimated the premium at 25%; the other in the range of 20% to 30%. The court accepted the more conservative estimate.

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[9] The price offered Korholz was $8.00, somewhat lower than the value found by the court (which is consistent with Korholz's refusal of the offer), but still higher, on a 1.9 ratio, than the July 2, 1965, price of $15.114.

[10] Of course, his fiduciary position would not prevent him from receiving *less* favorable benefits by giving up something of greater value than that surrendered by other Gypsum shareholders. Thus, plaintiff's argument does not meet the facts as found by the trial court.

Plaintiff argues that this estimate was less probative than the evidence showing the actual premium which Korholz paid when he made the original purchase from the Lannan Group on May 25, 1965. The cash price of $15.00 represented a premium of only about 10.7%[11] over the price of Susquehanna on that day.

There are a number of answers to this argument. The May transaction involved a different company (Susquehanna, not Gypsum), a relatively smaller block of stock, and took place at a different time. The price was set by the Lannans at a level which would make the prompt consummation of an all-cash transaction possible. The reaction of Korholz and the Gypsum board of directors, as well as the insurance companies and the Bank will tend to suggest that it was a bargain purchase from the buyers point of view. Finally, as the above discussion demonstrates, the argument is advanced in a factual context in which the district court's appraisal of the entire record is entitled to a special deference.

We are satisfied that the district court correctly concluded that Korholz realized no short-swing profit.

V.

There is one final contention to consider. After the trial was concluded, and based on the district court's finding that Korholz was a fiduciary for Gypsum with respect to the 430,000 shares of Susquehanna acquired on May 25, 1965, plaintiff filed a motion to amend the judgment to require Korholz to convey 25,000 additional shares to Gypsum.

The original discussions with the Lannan Group had contemplated a purchase of 455,000 shares. However, in May one member of the group, Wheelock Whitney, was out of the country. For that reason his 25,000 shares

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[11] The premium could be computed as high as 12% or as low as 9.6%, depending on the combination of ask and bid prices used.

could not be included in the May 25 purchase.[12] Accordingly, Korholz and an associate gave Whitney an option, exercisable by August 21, to sell his 25,000 shares at the $15.00 price. Whitney exercised the option and Korholz bought the stock.

Originally plaintiff argued that this purchase gave rise to § 16(b) liability. He has since abandoned that claim and, after judgment, argues that Korholz as a Gypsum director appropriated a Gypsum corporate opportunity. Assuming that plaintiff, as a Susquehanna shareholder, has standing to attack a pre-merger transaction affecting Gypsum, which is at best doubtful, and disregarding the inconsistency between this contention and plaintiff's denial of Korholz's fiduciary capacity between June 12 and July 2, 1965, we think it is plain that the attempt to raise an entirely new series of issues, both factual and legal, after judgment comes too late.[13] The trial court properly denied the motion to amend the judgment.

The judgment is affirmed.

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[12] And also for that reason, the May 12 resolution of Gypsum's directors referred to only 430,000 shares and not 455,000.

[13] *Cleary* v. *Indiana Beach, Inc.*, 275 F.2d 543, 546-47 (7th Cir. 1960), *cert. denied*, 364 U.S. 826 (1960); *Macris* v. *Sociedad*, 245 F.2d 708, 710-11 (2d Cir. 1957), *cert. denied*, 355 U.S. 922 (1958). The Supreme Court in *Forman* v. *Davis*, 371 U.S. 178 (1962), acknowledged that "the grant or denial of an opportunity to amend is within the discretion of the District Court," 371 U.S. at 182, and there required that there be a "justifying reason appearing for the denial." *Id.* Here the judge's order denying the motion is supported by "justifying reasons." He concluded the amendments "would not cause the pleadings on the judgment to conform to the evidence either as presented at trial or as formulated in the findings of fact," and that the amendments rested on a "theory never presented at trial." Indeed, the theory was directly inconsistent with plaintiff's theory of the case at trial and raised entirely new issues on which no evidence had been adduced, such as whether the Whitney transaction was a corporate opportunity in the first place and, if so, whether Korholz could defend on the grounds that the corporation had rejected the "opportunity" as to the Whitney shares.

SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

OCTOBER TERM 1971

Supreme Court, U.S.
FILED
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No. 71-804

GABRIEL WOLFF,

Petitioner,

v.

HERBERT F. KORHOLZ, MARTHA KORHOLZ AND THE SUSQUEHANNA CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION AND APPENDIX

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

OPINION BELOW

Petitioner failed to print the District Court's Opinion in his Appendix, contrary to Rule 23(1)(i) of this Court. The District Court made extensive findings of fact and conclusions of law which Respondent has included in the Appendix to this brief.

QUESTIONS PRESENTED

Whether this Court should review the decision below where:

1. The District Court found, and the Court of Appeals agreed, that under the facts of this particular case there was no "sale" within the meaning of §16(b) by Korholz when he purchased and transferred the Susquehanna shares to Gypsum.

2. The District Court and the Court of Appeals correctly valued the Gypsum shares owned by Korholz at the market price and held that Korholz realized no profit on this transaction.

3. There is neither an important public issue presented nor a conflict of decisions involved.

STATEMENT OF THE CASE

Prior to December 13, 1965, Respondent, Herbert F. Korholz was President and a member of the Board of Directors and Executive Committee of American Gypsum Co. ("Gypsum"). He and his family as a group owned approximately 56% of the outstanding Gypsum shares.

Early in May, 1965, Korholz learned that a block of Susquehanna stock representing control of that corporation was available from a number of persons known as the "Lannan Group." This was a corporate opportunity for Gypsum which had to be seized without delay since the Lannan Group had other offers and wanted to sell immediately for cash. The First National Bank of Boston, Gypsum's bank, agreed to lend Gypsum $6,450,000 to purchase the Susquehanna shares.

In order that the Bank's loan to Gypsum would have a prior lien on Gypsum's assets, it was necessary for two insurance companies, who were Gypsum's creditors, to give their consent. They did so orally and by telegram, but the Bank's counsel required formal documentation. This could not be completed before the deadline imposed by the

Lannan Group. An arrangement was then worked out with Gypsum, the Bank and Korholz whereby the Bank would make the loan to Korholz personally. Korholz would hold the Susquehanna stock until the documentation was completed and then he would transfer the shares to Gypsum. By resolution, the Gypsum Board of Directors authorized this procedure and agreed to acquire the shares from Korholz. All the Gypsum directors signed the resolution.

Korholz purchased the Susquehanna shares from the Lannan Group on May 25, 1965. He later transferred them to Gypsum at his cost when the documentation was completed. On December 13, 1965, Gypsum and Susquehanna were merged, the shareholders of Gypsum receiving 1 share of Susquehanna common stock for every 1.9 shares of Gypsum. Korholz and his wife exchanged their Gypsum shares for 526,273 shares of Susquehanna.

Petitioner brought this suit under §16(b) alleging that at the time Korholz transferred the Susquehanna shares to Gypsum, he "sold" Susquehanna shares within the meaning of §16(b). Petitioner claimed a §16(b) violation by matching the "purchase" of Susquehanna shares by Korholz at the time of the merger with the "sale" of Susquehanna shares by Korholz to Gypsum.

After seven days of trial, the District Court made extensive findings of fact and conclusions of law. The Court held that Korholz acquired the 430,000 shares of Susquehanna for and on behalf of Gypsum. Since Korholz purchased the shares as a nominee of Gypsum, there was no "sale" within the meaning of §16(b) when he transferred the shares to Gypsum (App. p. 21). Further, the Court held that, even if there were a "sale" of the Susquehanna shares within the meaning of §16(b), Korholz realized no profit on the transactions.

The Court accepted Petitioner's "sale" price of $15.114. In calculating the purchase price of the Susquehanna shares at the time of the merger, the Court looked at the December 13, 1965, market value of the Gypsum shares which Korholz

exchanged for the Susquehanna shares. Since no actual trading in Gypsum shares took place that day, the Court took an average of the highest bid and the lowest asked over-the-counter quotations. This yielded a market value of $6.875 per share.

The unrefuted expert testimony at trial was that shares which represent control of a corporation are worth a premium of 20 to 30% over market value. Since Korholz and his family owned 56.7% of the Gypsum shares, the Court added a minimum premium of 20% to his shares. When this figure was multiplied by the merger exchange ratio of 1.9, the Court computed $15.60 as the fair market value of each share of Susquehanna purchased by Korholz. Thus, even assuming a §16(b) "sale," Korholz could realize no profit because his purchase price was greater than the price at which he transferred the shares to Gypsum (App. p. 19).

The Court of Appeals did not reach the question of whether Korholz had sold the 430,000 Susquehanna shares to Gypsum within the meaning of §16(b). Although the Court clearly expressed its skepticism that the transaction came within §16(b), it nevertheless assumed Petitioner's "truncated" version of the facts, and upheld the District Court's finding that Korholz realized no profit on the transaction.

ARGUMENT

I. THE FACTS OF THIS CASE CLEARLY ESTABLISH THAT NO VIOLATION OF § 16(b) OCCURRED.

At trial, Petitioner failed to establish that a violation of §16(b) had occurred. The undisputed facts clearly showed that Korholz acted as the agent or nominee of Gypsum when he purchased the 430,000 shares of Susquehanna from the Lannan group and that the purchase of these shares was a corporate opportunity for Gypsum which Korholz, as a fiduciary, could not appropriate for himself (App. p. 3).

Therefore, the District Court held that the transfer of these shares by Korholz to Gypsum did not constitute a "sale" within the meaning of §16(b).

The Court of Appeals viewed the facts as a three-step transaction by Korholz, the first two of which were for the benefit of Gypsum. However, the Court did not reach the question of whether there was a "sale" within the meaning of §16(b). It decided the case on the grounds that Korholz realized no profit on the transaction. The Court stated:

> "In addition, we note that plaintiff's entire case is predicated on acceptance of a truncated version of the transaction as including only steps two and three. *As originally intended, and as ultimately consumated, his participation in steps one and two was entirely for the benefit of Gypsum and its stockholders* . . . Nevertheless we accept plaintiff's truncated version of the transaction for purposes of our decision." (Emphasis added) (Petition, pp. 7a-8a).

Further, the Court noted:

> "Indeed, the predicate for plaintiff's entire statutory case is a denial of a continuing fiduciary relationship between June 12 and July 2, 1965." (Petition, p. 8a, fn. 4.)

Thus, the unique facts of this case, as found by the District Court and concurred in by the Court of Appeals, established that no "sale" of the Susquehanna shares was made by Korholz to Gypsum within the meaning of §16(b). This alone is sufficient to warrant the denial of the petition for certiorari.

II. THE VALUATION BY THE DISTRICT COURT AND THE COURT OF APPEALS OF THE GYPSUM SHARES OWNED BY KORHOLZ ON DECEMBER 13, 1965 WAS CORRECT AND IN HARMONY WITH § 16(b) AND COURT DECISIONS INTERPRETING THAT SECTION.

Petitioner does not contest the well-settled proposition that the purchase price of stock under § 16(b) is determined by the value of the "consideration parted with" by the purchaser. *Blau v. Mission Corp.*, 212 F.2d 77, 81 (2d Cir. 1954), *cert. denied*, 347 U.S. 1016; *Park & Tilford, Inc. v. Schulte*, 160 F.2d 984, 988 (2d Cir. 1947), *cert. denied*, 332 U.S. 761; *Stella v. Graham-Paige Motors Corp.*, 259 F.2d 476, 479 (2d Cir. 1958), *cert. denied*, 359 U.S. 914; *Blau v. Lamb*, 242 F. Supp. 151, 160 (S.D. N.Y. 1965), *rev'd on other grounds*, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002.

Therefore, the purchase price of the Susquehanna shares which Korholz received in exchange for his Gypsum shares pursuant to the Gypsum-Susquehanna merger on December 13, 1965 is determined by the value of his Gypsum stock on December 13, 1965. Both the District Court and the Court of Appeals correctly valued Korholz' Gypsum shares.

1. The Average of the Highest Bid-Lowest Asked Price on the Over-the-Counter Market Accurately Reflected the Market Value of Gypsum Shares on December 13, 1965.

Prior to the merger with Susquehanna, shares of Gypsum were traded in the over-the-counter market. On December 13, 1965, the date of the exchange of Gypsum shares for Susquehanna shares pursuant to the merger, there were no actual trades in Gypsum shares. Therefore, based upon Respondent's uncontested expert testimony at trial, the District Court found that the average of the highest "bid" and lowest "asked" price quoted on December 13 reflected the market value of Gypsum stock. Thus, the Court arrived at market value by averaging the highest price a purchaser

would pay with the lowest price a seller would sell Gypsum shares on this particular day (App. p. 19).

Plaintiff's contention that the lowest bid price must be used is untenable. As the Court of Appeals stated:

> "It [*Smolowe v. Delendo Corp.*, 136 F.2d 231 (2d Cir. 1943)] does not require a court to adopt a completely unrealistic interpretation of the market. In this case the evidence shows that the owners of Gypsum were unwilling to sell for less than $7.125 a share and prospective purchasers were willing to pay $6.75. Clearly a finding that the market value was only $6.00 would be unsupportable." (Petition, p. 10A).

Petitioner has attempted to create a conflict on this point with other Court decisions. No such conflict exists. All of the cases cited by Petitioner involve circumstances in which the Courts had to place a value on the consideration given up by the insider. Each used the actual selling price of the stock on the particular day. *Smolowe v. Delendo Corp., supra*, (Court took the lowest *actual* purchase price and matched it with the highest *actual* sale price); *Marquette Cement Mfg. Co. v. Andreas*, 239 F. Supp. 962 (S.D. N.Y. 1965) (Court took the lowest *actual* sales price on the N.Y. Stock Exchange of Marquette common stock on February 3, 1961); *Heli-Coil Corp. v. Webster*, 222 F. Supp. 831 (D. N.J. 1963), *modified*, 352 F.2d 156 (3rd Cir. 1965) (Court took the *actual* sale price of Heli-Coil debentures in the over-the-counter market to determine the purchase price of the common stock into which the debentures had been converted); *Blau v. Lehman*, 173 F. Supp. 590 (S.D. N.Y. 1959), *aff'd*, 286 F.2d 786 (2d Cir. 1960), *aff'd*, 368 U.S. 403 (Court took the lowest *actual* sale price of Tidewater common on the day of conversion to ascertain the purchase price of the preferred stock); *Blau v. Lamb*, 242 F. Supp. 151 (S.D. N.Y. 1965) (Court took the highest *actual* market price of Air Way common on the date the Air Way preferred stock was converted into the common to determine the "sale" price of the preferred at the time of conversion. On

appeal, the Second Circuit held that the conversion was not a sale within the meaning of §16(b). 363 F.2d 507, 517).

When the Courts speak of "squeezing out" all possible profits under §16(b), this has reference to the Courts' refusal to match particular individual shares which are bought and sold by the insider within 6 months. Instead, the Courts match shares by using the lowest purchase price and the highest sales price. In this way, the insider cannot attempt to minimize his profits on individual shares. *Smolowe v. Delendo Corp., supra.*

However, the "squeezing out" of all profits theory has absolutely no relevance to this case. That theory is based on the prices of actual purchases and sales and does not require the adoption of a purchase price which is not based on market value. In this case, the District Court found, and the Court of Appeals adopted, a realistic market value of Gypsum shares by averaging the highest bid price with the lowest asked price on December 13, 1965. This is in complete harmony with the intent and purpose of §16(b).

2. A 20% Premium Was Properly Added to the Control Bloc of Gypsum Shares Owned by Korholz.

Two well-qualified experts testified at trial that a bloc of shares which represent control of a corporation is worth a 20 to 30% premium over the market price of non-control individual shares. Petitioner did not offer any testimony or other evidence to contradict this expert testimony. Since Korholz and his family owned 56% of the outstanding Gypsum stock, the District Court added a 20% premium to the market value of his shares at the time of the merger.

Petitioner contends that the addition of such a premium will hinder the enforcement of §16(b). This is not the case. The law is clear that the value of the consideration given up for the stock determines the purchase price.

If the insider pays cash for the stock, as is the usual case, there is little difficulty in valuing the consideration given for the stock. However, when the consideration involves shares of another company, as in the instant case, a realistic market value must be placed on those shares. The uncontroverted evidence in this case is that a realistic market value of a control bloc of Gypsum shares was worth a 20% premium above the market price of non-control individual shares.[1] This is perfectly consistent with the intent and purpose of §16(b).

3. Where There Were No Actual Trades of Gypsum Shares on December 13, 1965, the Use of Over-the-Counter Quotations Was Proper To Determine Market Value.

On the day of the merger, December 13, 1965, no shares of Gypsum were actually traded. Therefore, the Court used the next best evidence to establish market value—the bid-asked over-the-counter quotations. Reliance on these quotations was proper, since Gypsum was actively traded, and the quotations listed firm offers to buy and sell by ten brokerage houses or dealers who actively traded in the stock. *Jaffe v. Cruttenden*, 412 Ill. 606, 615-16, 107 N.E.2d 715, 721 (1952); *In re Allender Co.*, 9 S.E.C. 1043, 1057-58 (1941); *In re Charles Hughes & Co.*, 13 S.E.C. 676, 678-79 (1943); Bosland, *Valuation Theories and Decisions of the Securities and Exchange Commission* (1964), p. 87.

Again, Petitioner manufactures a conflict with other decisions where no conflict exists. In *Kramer v. Ayer*, 317 F. Supp. 254 (S.D. N.Y. 1970), the Court, in denying motions for summary judgment, held that actual sales figures on a certain day, if there were any, should be used rather than bid-asked quotations. In *Franklin Nat'l. Bank v. L.B. Meadows & Co.*, 318 F. Supp. 1339 (E.D. N.Y. 1970), a suit under §15 of the Securities Exchange Act by the bank

[1] Korholz in fact received a prior offer of $8 per share for all his Gypsum stock which included a premium above the market price. (App. p. 19).

against four broker-dealers for giving fictitious quotations to the National Quotation Bureau, the Court denied a motion for summary judgment. It held that it was a factual question whether it was reasonable for the bank to rely on the "pink sheet" quotations to value stock held as security for a loan. The Court recognized that the "pink sheets" are widely used. *Id.* at 1345.

4 § 16(b) Requires the Use of Market Values in Determining Purchase Price and Not Merger Appraisal Values.

Petitioner contends that the Court of Appeals should have relied on the merger appraisal values to determine the value of Korholz' Gypsum shares exchanged pursuant to the merger. The Court accurately disposed of this contention:

> "*Plaintiff omits mention of the fact that appraisal values determined for reorganization purposes are not market values.* Susquehanna's $10.75 per share value was the so-called 'break up' value determined by valuing all of Susquehanna's assets and dividing the total by the number of outstanding shares. On the other hand, the $5.65 per share value of Gypsum was the 'going concern' value based upon the experts' analysis of earnings, appropriate capitalization rate and other factors. *These figures were not intended to represent the market price in August, 1965, or at any other time.*" (Emphasis added) (Petition, p. 6a, fn. 3)

Merger appraisal figures are used to evaluate the contribution that each company will make to the surviving company and to establish a fair stock exchange ratio. These figures are not market prices.

In no way does *Stella v. Graham-Paige*, 259 F.2d 476 (2d Cir. 1958) lend support to Petitioner's position. That case involved the valuation of 750,000 shares of Kaiser-Frazer stock which Graham-Paige received in exchange for the sale of all of its assets to Kaiser-Frazer. The Board of

Directors of Kaiser-Frazer had valued the Graham-Paige assets at $4,875,000, which was based upon the net proceeds the Company would receive if it sold the shares at market to the public. The Court held that the Board's valuation should be used to determine the purchase price of the Kaiser-Frazer shares. Since the selling price was lower than the purchase price, defendant Graham-Paige realized no profit under § 16(b).

C. CERTIORARI SHOULD BE DENIED SINCE NO PUBLIC ISSUES OR CONFLICT OF DECISIONS ARE PRESENTED IN THIS CASE.

This Court held in *Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393:

> ". . . [I]t is very important that we be consistent in not granting the writ of certiorari except in cases involving principles the settlement of which is of importance to the public as distinguished from that of the parties, and in cases where there is a real and embarrassing conflict of opinion and authority between the circuit courts of appeal."

This case involves basically a dispute over the particular facts found by the District Court after a week-long trial, with the Court of Appeals affirming the result. Petitioners have failed to show that the case presents important public issues which would warrant this Court's review.

Further, not only is there no "real and embarrassing conflict of opinion and authority between the circuit courts of appeal," there is no conflict whatsoever. The decision of the Court below is entirely consistent with decisions of other circuits which have considered the questions involved.

CONCLUSION

The Petition for Certiorari raises no issue of sufficient importance to justify consideration by this Court, points to no conflict of decisions, and shows no error in the Court below. The Petition should be denied.

Respectfully submitted,

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January 20, 1972

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

PAUL MUELLER and GABRIEL WOLFF, Plaintiffs,	)	
v.	)	NO. 66 C 69
HERBERT F. KORHOLZ, MARTHA KORHOLZ, and THE SUSQUEHANNA CORP., Defendants.	)	

ORDER

The Court having heard the above entitled case after full trial, having considered the contentions of the parties, having adopted Findings of Fact and Conclusions of Law, and having determined that Defendant Korholz in acquiring the 430,000 shares of The Susquehanna Corporation stock acted on behalf of his corporation, American Gypsum Company, that no "sale" and "purchase" within six months by Defendant Korholz of such stock took place within the meaning of Section 16(b) of the Securities Exchange Act of 1934; and that Defendant Korholz did not realize a profit within the meaning of Section 16(b), because the price per share of Susquehanna on December 13, 1965 incident to the merger was as high as the July 2 price; and that Defendant Martha Korholz performed no act which might subject here to liability under Section 16(b), it is hereby

ORDERED that the above-entitled action be and the same is hereby dismissed with prejudice, with costs.

ENTER: /s/ Alexander J. Napoli
UNITED STATES DISTRICT JUDGE

DATED: June 10th, 1969

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This is an action under Section 16(b) of the Securities Exchange Act of 1934. 15 U.S.C. §§ 78a et seq. Plaintiffs claim that on July 2, 1965 Defendant Herbert F. Korholz made a "sale" to American Gypsum Company (Gypsum) within the meaning of Section 16(b) of 430,000 shares of The Susquehanna Corporation (Susquehanna); that on December 13, 1965, less than six months later, Defendant Korholz made a "purchase" of a larger number of Susquehanna shares, incident to the merger between Gypsum and Susquehanna; and that since the "purchase" was at a price lower than the July 2 "sale," Defendant Korholz is liable for the "profit realized."

We find the evidence to be that Korholz, in the transaction leading up to the events of July 2, acted on behalf of Gypsum, of which he was President and a majority stockholder, Korholz discovered a corporate opportunity for Gypsum to acquire the 430,000 shares of Susquehanna. The opportunity had to be seized without delay. However, some delay was required because the First National Bank of Boston (Bank), which financed the transaction, insisted that Gypsum obtain formal consents from two insurance company lenders. William L. Brown, Vice-President of the Bank, arranged to make a 30-day loan to Korholz of $6,450,000 so that he could acquire the stock temporarily and turn it over to Gypsum once the consents had been obtained.

The Gypsum Board of Directors adopted a resolution on May 12, 1965 that Gypsum would take the Susquehanna stock from Korholz at his cost plus expenses. The insurance companies gave oral consents to Brown, and on May 12 and May 14 they confirmed their consents by telegram. The Susquehanna stock was deposited in escrow with the Bank, Korholz delivered his 30-day note to the Bank for $6,450,000, and on May 25, payment was made for the stock.

Thereafter, formal consents were executed by the insurance companies, by aggrements dated June 9, 1965, and under date of July 2, 1965 the Bank switched over the loan to Gypsum.

On August 24th, 1965 Korholz bought 12,500 shares of Susquehanna at $15 per share. In early December, 1965 Susquehanna and Gypsum merged. Papers were filed in New Mexico on December 10th and in Delaware on the 13th. As a result of this merger Korholz received approximately 380,000 shares of Susquehanna and his wife received 140,171 shares.

On the facts, no liability can arise against Korholz under Section 16(b). He acquired and held the stock on behalf of Gypsum, as its agent, and on "purchase" or "sale" by Korholz should be recognized under the statute. See *United States v. A. B. Leach & Co., Inc.*, 84 F.2d 908, 909 (7th Cir. 1936); *Schuh Trading Co. v. Commissioner of Internal Revenue*, 95 F.2d 404, 411 (7th Cir. 1938). The beneficial interest in the Susquehanna stock was not in Korholz but in Gypsum. *Marquette Cement Mgt. Co. v. Andreas*, 239 F. Supp. 962, 967 (S.D.N.Y. 1965).

Plaintiffs point to a Form 3 filed by Korholz with the SEC, dated June 24, 1965, which states that he was the beneficial owner of the Susquehanna stock. However, the filing of such a Form without a disclaimer has little bearing on the question of Section 16(b) liability. *Marquette Cement Mfg. Co. v. Andreas, supra*, 239 F. Supp. at 967; *Chemical Fund, Inc. v. Xerox Corp.*, 337 F.2d 107, 112 (2d Cir. 1967).

The transfer was "involuntary" on the part of Korholz, because he was under a fiduciary duty to transfer the stock to Gypsum. Moreover there was no evidence of insider abuse on short swing speculation on the part of Korholz. *Ferraiolo v. Newman*, 259 F.2d 343, 346 (6th Cir. 1968); *Petteys v. Butler*, 367 F.2d 528, 534, 537 (8th Cir. 1966).

Assuming that a "sale" occurred on July 2, the price on that date as claimed by Plaintiffs is $15.11—the $15 price plus expenses. The price at which Korholz is deemed to have made a "purchase" of Susquehanna stock incident to the merger on December 13, 1965 is the value of the consideration which he parted with to obtain the Susquehanna stock. *Blau v. Mission Corp.*, 212 F.2d 77, 81 (2d Cir. 1954); *Park & Tilford, Inc. v. Schulte*, 160 F.2d 984, 988 (2d Cir. 1947). Defendants' experts have established that since the Gypsum stock which Korholz exchanged in the merger was control stock in Gypsum; the Korholz Gypsum stock was worth a premium of at least 20% more than other Gypsum stock, or a minimum of $8.25 per share. At the 1.9 to 1 merger exchange ratio, each share of Susquehanna stock which Korholz was entitled to receive in the merger was worth at least $15.60. Since this exceeded $15.11, Korholz did not realize any profit within the meaning of Section 16(b).

Defendant Martha Korholz took no part in the 430,000 share transaction except to pledge her stock as collateral, and she has incurred no liability under Section 16(b).

Plaintiffs' secondary claim against Korholz arises from the fact that in May, 1965 Korholz gave one Whitney a "put" for 25,000 shares of Susquehanna stock at $15 per share which Whitney could exercise in August. Plaintiffs' theory, as stated at the close of trial, is that Korholz purchased 25,000 shares from Whitney in August and immediately made a "sale" of 12,500 shares to Samuel Ferguson, his associate. However, prior to the time Whitney exercised the "put," Korholz had made a commitment with Ferguson whereby, if Whitney exercised the "put," Korholz and Ferguson would each take 12,500 shares. When Whitney exercised the "put" Korholz had "firm assurances" to acquire only 12,500 shares, and therefore his "purchase" from Whitney, under Section 16(b), was 12,500 shares, not 25,000 shares. *Blau v. Ogsbury, supra.* Since Korholz purchased and still owns the 12,500 shares there is no purchase and sale within the requirements of Section 16(b). Rule 15(b), F.R.C.P.

Finally, the 12,500 share purchase cannot be matched against the prior 430,000 share transaction, because that transaction was not a "sale" by Korholz within the meaning of Section 16(b).

This cause coming on for trial and having been tried by the Court without a jury and the Court having heard the evidence, considered the arguments and memoranda of counsel for the parties and being fully advised in the premises, finds as follows.

FINDINGS OF FACT

1. Both plaintiff Paul Mueller and Intervening Plaintiff Gabriel Wolff prior to April 1, 1965, and continuously thereafter at all significant times were the record and beneficial owners of shares of capital stock of The Susquehanna Corporation.

2. Demand upon Susquehanna's Board of Directors to bring this action against the individual defendants would have been futile. Tr. 342, 421, 623.

3. Intervening Plaintiff Gabriel Wolff, through his attorneys requested on January 10, 1966 that Susquehanna bring this cause against the individual defendants and said request was refused. Further, Susquehanna took no action to enforce such claims or otherwise comply with the request within the 60 day period provided for by § 16(b). Tr. 41, 42.

4. Korholz and Martha Korholz are husband and wife and Korholz by virtue of the share holdings of his wife and their three daughters controlled Gypsum, a New Mexico corporation. Korholz and his wife and children owned 56% of Gypsum's shares. Korholz at all relevant periods was Gypsum's president, a member of its Board of Directors and its executive committee.

5. Korholz dominated and controlled the Gypsum shares held by defendant Martha Korholz and his daughters and the shares held by each in Gypsum were voted by and under

the direction of Korholz and pledged as he directed. Tr. 65, 126-27, 871 PX 32. The loans made by the insurance companies to Gypsum were conditioned upon retention by defendant Korholz and his family of at least 1,000,000 Gypsum shares, a condition which could not be fulfilled unless both defendants' holdings were retained. Tr 366. Korholz and his family as a group held approximately 1,375,000 shares of Gypsum. DX 121.

6. Susquehanna at all pertinent times was and is a Delaware corporation. During the period from May through December, 1965, it had outstanding voting stock of approximately 2,488,000 shares of capital stock which were traded in the over-the-counter market. It had over 5,000 stockholders and $27,000,000 in assets. These capital shares were a class of equity security and Susquehanna's sole voting shares. PX 23.

7. On May 18, 1965, Korholz was elected a director of Susquehanna, a member of its executive committee and Chairman of its Board of Directors. Tr 249, 426, 514-15, PX 13, PX 39. By virtue of the purchase of that block of Susquehanna shares, on May 25, 1965, defendant Korholz was enabled to exercise control of Susquehanna and its Board of Directors. Tr 342, 421, 623, 632, 688.

8. By July 2, 1965, Susquehanna's capital stock became registered by virtue of a registration statement filed pursuant to the provisions of § 12(g) of the Securities Exchange Act of 1934, (15 U.S.C. § 78 l). PX 51

9. In March, 1965, Gypsum entered into separate indenture agreements with Massachusetts Mutual Life Insurance Company and State Mutual Life Assurance Company of America, under the terms of which those companies purchased Gypsum's promissory notes in the principal amounts of $3,500,000 and $2,500,000, respectively. Tr 348. These agreements impose certain restrictions on borrowing by Gypsum, Tr. 255, liens on Gypsum's assets, Tr 356, and Gypsum's investments in other corporations, Tr 360, DX 7, DX 8.

10. On or about May 1, 1965, Korholz learned that a block of Susquehanna shares representing control of that corporation was available for purchase from a number of persons known as the "Lannan group." Tr. 43, 170, 339, 440-41, 688, 862-63. This block ultimately aggregated some 485,000 shares and constituted in excess of 18% of Susquehanna's outstanding stock. The Lannan group conditioned any sale of this stock upon payment in cash. Tr 170, 195, 198, 338-342, 393-93, 396, 471, 644.

11. Korholz had learned there was dissension on the Susquehanna Board of Directors and that the Lannan group desired to sell. Tr. 173, 174, 370, DX 10, 11, 12.

12. Korholz determined to attempt the acquisition of the control block for Gypsum and so notified Gypsum's Board of Directors. Immediately thereafter he entered into negotiations in this respect with representatives of the Lannan group. Tr. 173-77, 193. At about the same time, Korholz advised William Brown, Vice-President of the First National Bank of Boston ("Bank"), of these negotiations and of Korholz's intention to seek to arrange for the financing by the Bank of 100% of the purchase price to be agreed on for the Susquehanna shares. Tr 174-78, 613, DX 12A, DX 19, DX 20, PX 23.

13. From the beginning Korholz presented the matter to Brown as a purchase of the Lannan shares, not by Korholz, but by Gypsum. DX 12A.

14. Brown, who had been instrumental in arranging Gypsum's $6,000,000.00 refinancing with Massachusetts Mutual and State Mutual, and was familiar with both Korholz and Susquehanna, indicated the willingness of the Bank to provide such financing for Gypsum but pointed out to Korholz the inability of Gypsum to incur the proposed indebtedness to the Bank or to acquire the Lannan block because of restrictions contained in the insurance companies' indenture agreements. The Bank would permit Gypsum to be the borrower only if Massachusetts Mutual and State Mutual first amended the indenture agreement so as to permit the

borrowing and thus assure the Bank of its first lien upon the Susquehanna shares so purchased and Gypsum's assets. Tr. 184, 185, 195, 349, 380, 623-29, 650-51, 652-53, 665-66.

15. Korholz and Brown thereafter met with representatives of Massachusetts Mutual and State Mutual. The representatives reacted favorably to the proposed purchase. Tr 183-86, 436, 650-53. Tentative agreement was given by the insurance companies to amend the insurance indentures upon the conditions that Gypsum would be required to agree to repay the Bank loan upon merger into Susquehanna, that Gypsum would be required to agree to reduce the Bank loan upon sale of its Albuquerque, New Mexico plant, and that Korholz and two other directors of Gypsum would be elected directors of Susquehanna and have the power to appoint two additional directors thereafter. Tr 184, 444-47, DX 16, DX 17, DX 14, DX 15. The first two conditions required Gypsum Board of Director approval and the third condition was not contained in the final amendments to the indenture agreements. Tr 461-62, DX 60, DX 61. Minutes of Gypsum's executive committee reflected a meeting which was purportedly held on June 21, 1965 (DX 68, Item 6) which approved the two remaining conditions and authorized Gypsum's purchase of Korholz' shares but was not held as the evidence shows and the defendants themselves admit. Tr 737, 743-44, 771, 777-78.

16. These lenders were asked to confirm their oral consents in telegrams. This they did on May 12 and 14. Tr 618, DX 15, 24, 25. Each insurance company lender considered its telegraphic consent as a writing satisfying the respective loan agreements with Gypsum. Tr 752, 965-66, DX 7, 8.

17. The Bank's lawyers advised that as a prerequisite to the $6,450,000 loan, written documents of consent should be drafted and signed. Tr 662, 667, 696, 723.

18. Korholz on May 11 went again to Chicago to meet with representatives of the Lannan group. They stressed that Gypsum must act quickly or another buyer offering the same price, or one of several merger offers, would be

accepted by the Lannan group. Tr 193, 198, 340, 345, 472-73.

19. The insurance companies' indentures not yet having been amended and being advised that the Bank could not make the loan to Gypsum, Korholz (as advised by Brown) determined to purchase the Susquehanna shares himself for Gypsum. Tr 210, 223-24, 386, 454-56, 477, 500, 532, 665, 668, 669-70, PX 5A (p. 3), PX 12, PX 18, PX 20 (p. 6), DX 60, DX 61.

20. Brown decided to use Korholz as an "intermediary" rather than wait for the formal consents. Before making the loan to Korholz, Brown insisted on documentation, namely, a proper Board of Directors resolution and a signed note, establishing that Gypsum would acquire the stock when the formal consents were executed. DX 19, 20, Tr 624, 639-40, 672, 693-94, 723.

21. Korholz then informed the representatives of the Lannan group that he would be the purchaser of the Susquehanna shares. Tr 474, 477. The Lannan group placed severe time pressure upon Korholz to complete any purchase of their Susquehanna shares. Tr 46, 52, 182, 193, 197, 198, 482. Other purchasers were supposedly available and Korholz was required by them to arrange for financing and close the transaction within days. Tr 34, 473, 477, 628, 665-66.

22. On May 12 a meeting of Gypsum's Board was held in Albuquerque, New Mexico to consider the Susquehanna stock purchase. DX 13, Tr 198-99, 209-216. At the Board meeting, Korholz brought the directors up to date on his negotiations with Brown and the insurance companies. He told them that the insurance company executives had given assurances that they would consent to the Gypsum loan to purchase the stock. Tr. 222-224. See also Tr. 449, 490-493, 502, 731, 761-763. Korholz testified that he had informed the directors at the Board meeting that "Mr. Brown had committed himself and the Bank to an advance of funds to American Gypsum Company, but provided that the amendments were satisfactory to the attorneys for the Bank. But

he had also committed himself that if that could not be done in time, he would advance the moneys to purchase the stock to me so that I could acquire it on behalf of Gypsum, provided that I would put up all, as collateral, my personal holdings of Gypsum, those of my wife Martha, and I think those of my children . . ." Tr. 224.

23. In anticipation of and in order to provide for the transfer to Gypsum of the Susquehanna shares to be purchased by him, on May 12, 1965, Gypsum's Board of Directors adopted a resolution (DX 13) which was the only written agreement between Gypsum and Korholz, Tr 54, the operative portions of which read as follows:

> "NOW, THEREFORE, BE IT RESOLVED: That if Herbert F. Korholz and Martha Korholz acquire 430,000 shares of Susquehanna at $15.00 per share and if consents are first had and received from the insurance companies to which this company is indebted under certain loan indentures permitting acquisition of said shares, the company will acquire from Herbert F. Korholz and Martha Korholz said approximately 430,000 shares of the common stock of The Susquehanna Corporation at $15.00 per share, together with reimbursement to Herbert F. Korholz and Martha Korholz of any costs and expenses (including any interest expense incurred by them) incident to said acquisition; provided that such consents are received within one month from the date of this resolution. If such consents are not received, the company shall be under no obligation to Herbert F. Korholz and Martha Korholz in connection with their acquisition of said shares. If Herbert F. Korholz and Martha Korholz do not acquire said shares, they shall be under no obligation to the company in connection thereunder.
>
> FURTHER RESOLVED: That the President and Secretary of this company are hereby authorized and directed to enter into an agreement with Herbert F. Korholz and Martha Korholz in form and substance necessary to carry out the intent of this Board as reflected in the foregoing resolutions."

24. In a unique act, all members of the Board signed this resolution even though it was in the body of the minutes and usually only the Chairman and Secretary signed Gypsum minutes.

25. No other understanding was ever entered into between Gypsum, Korholz and/or Martha Korholz. Tr 511. It was understood by Gypsum's directors that Korholz was to purchase the Susquehanna stock for the company and in the best interests of the company. Tr 783.

26. The Bank on or about May 12, 1965, requested and received a blank promissory note from Gypsum. Tr 476, PX 7, DX 19. The blank note signed by directors of Gypsum prior to May 17 and by Korholz on May 17 was filled in with a July 2 date and in the amount of $6,450,000.00 DX 19, 76, Tr 243-44, 627-644, 765 to replace Korholz' note in payment for the stock.

27. On May 12 the Executive Committee of Massachusetts Mutual formally determined to authorize officers of the company "to consent to modification of the Note Agreement . . ." DX 16, 17. The Massachusetts Mutual memorandum of May 12 states:

> American Gypsum has an opportunity to purchase between 400,000 and 430,000 shares of the common stock of Susquehanna Corporation at a cost of $6,000,000 to $6,450,000. . . .
>
> It is recommended that we allow the $6,450,000 bank loan to acquire the 15% stock interest in Susquehanna. The Susquehanna merger of American Gypsum into Susquehanna will result in a very strong company with substantial liquid assets and will provide a strong base for the highly regarded Mr. Korholz to make additional acquisitions. . . .

28. On May 12, 13 and 14, 1965, telegrams were sent by the insurance companies to which Gypsum was indebted to the Bank which are asserted by defendants to be the consents contemplated by the May 12 Gypsum resolution.

These telegrams contained conditions as heretofore described which were fulfilled or waived at a later date. Tr 458-62, 468-69, 663, 988-89, 1001-02, DX 23, DX 60, DX 61. Brown was positive that the formal consents would be forthcoming in a short time. Tr 693-694, 723. However, the Bank would not loan any monies to Gypsum based upon these telegrams. Tr 539, 623-24, 696.

29. Brown on May 12 also sent Korholz pledge agreements to be signed by Korholz and Mrs. Korholz and their daughter, explaining that these would be used when Gypsum picked up the stock if the loan was not made to Gypsum in the first instance. These were executed and delivered to Brown. DX 20, Tr 211-219, 686.

30. Because Gypsum was unable to obtain the necessary insurance company amendments to the indenture agreements to the indenture agreements in time to consummate the purchase transaction with the Lannan group, Korholz determined on the advice of Brown on May 14, 1965 to purchase the Susquehanna block for himself. Accordingly, he offered to purchase these Susquehanna shares by a tender offer. PX 13.

31. In order to carry out the tender offer, Korholz created an escrow at the Bank (accepted by it on May 17, 1965) whereby Susquehanna shares were deposited in the escrow by members of the "Lannan" group desiring to sell their shares and the Bank deposited $6,450,000 to Korholz's account in order to pay for the shares. Tr 237, 484-66, PX 12, DX 22. Ultimately, 430,000 Susquehanna shares were purchased and as required by his escrow agreement were held for Korholz's account by the Bank. Tr 335, PX 64, PX 12, PX 10, PX 62, PX 26, PX 54 (Item 2), DX 68.

32. The stock was placed in escrow by May 20 and paid for May 25. PX 10, DX 54. The stock went into escrow in street or blank form and came out that way. The stock was never in Korholz' name. It was held in blank form at the Bank until the loan was switched over to Gypsum, when it was registered in the name of Gypsum. The stock was never

transferred to the name of Korholz personally. Tr 267, 637, 727-28, 818; 819.

33. Brown was willing to use Korholz as an intermediary or straw, and to make the loan to him on an interim basis, because he relied on Korholz and on the telegraphic consents, In view of his long experience with the insurance companies. Tr. 628-629, 667, 668. Before proceeding with the loan to Korholz, Brown had in hand a blank note executed by officers of Gypsum and he also had a certified copy of the resolution of the Gypsum Board of Directors which established in his mind that Gypsum would take over the stock from Korholz and borrow the money from the Boston Bank, once the insurance company consents had been obtained. Tr. 629, 668-670, 745-765, 792, DX 19.

34. Korholz had conferred on and approved the first draft of the consents May 17 and they were forwarded to the insurance company lenders May 18. This draft is essentially identical, except for technical amendments, with the formal consents executed on June 9, DX 14, 15, 45, 60, 61.

35. On May 18 Korholz and two Gypsum Directors were elected Directors of Susquehanna, Korholz being named as Chairman and Chief Executive Officer of Susquehanna. Thus were fulfilled the first two conditions stated in the State Mutual telegram of May 14. DX 24, 39, Tr 248-252.

36. By May 18 Gypsum had agreed to or satisfied the stipulations in the insurance company telegrams of May 12 and May 14. DX 15, 24, 39, 45, 60 Tr 248.

37. In order to make the tender offer to the "Lannan" group effective, Korholz had executed a personal promissory 30-day note for $6,450,000 dated May 20, 1965 made payable to the Bank. Tr 52, 266, 516-17, 69, PX 5A. As security for his obligation, Korholz pledged 253,980 of his own Gypsum shares, 266,325 of Martha Korholz's Gypsum shares, his H. F. K. shares and the Susquehanna shares to be purchased by him. Tr 518-19, PX 5A (pp. 1, 3). Also, all of Korholz's daughters pledged their Gypsum shares. Tr 520. The note

was for only 30 days because everyone expected that in a very short time Gypsum would take over the loan. There was never any intent for Korholz to borrow the money and hold the stock on a long term basis. DX 48, PX 5A, Tr 260-61, 631-34.

38. Korholz signed that note in reliance upon the Board resolution of May 12, the Gypsum note signed in blank, the election to the Susquehanna Board of Korholz and the Gypsum directors, and the Bank's agreement to loan the money to Gypsum to pay for the stock. Tr 256-58, 327-330, 454, PX 30A, DX 12, 15, 39, 45, 60, 61.

39. The Bank was looking not just to Korholz but to the full corporate assets of both Susquehanna and Gypsum as security. The loan to purchase the stock had as security stock representing control of both Susquehanna and Gypsum as well as all of Korholz' stock. Tr 623, 629, 632, 687, 688, PX 7, DX 35.

40. On June 7 both insurance company lenders had agreed to the final text of the formal consents. DX 58, 59, 60, 61, Tr 754-55, 967, 1005-07. Korholz signed the previously agreed upon drafts of the formal consents on June 9. DX 60, 61, Tr 269-271. The insurance companies both signed the previously agreed upon consents June 14 but did so expressly "as of" June 9. Both insurance companies considered the consents binding as of June 9, their agreed upon date. DX 45, 57, 60, 61, 62, 63A, 65, Tr 755-758, 968-970, 990. In any event, Gypsum had no reason to insist on strict compliance with the provision in the resolution requiring the obtaining of consents within one month. Tr 225. Gypsum must be deemed to have waived any asserted delay in obtaining consents from the insurance companies. Tr 223-25, 694, 748, 763-64, 773.

41. As agreed to in the tender offer (PX 13), on or about June 23, 1965 (but relating back to his purchase of the Susquehanna shares in May, 1965), Korholz executed an investment letter in which he warranted to the "Lannan" group that he was acquiring the Susquehanna shares personally

and this personal acquisition was the basis of the transaction, Korholz reserving to himself the right to transfer such shares to Gypsum at cost or another corporation of which he owned more than 50% of the outstanding shares. Tr 525-27, PX 18 (p. 1), PX 18D, PX 18C, DX 35.

42. When Korholz signed this investment letter on June 25 the consents including those of June 9 rendered it beyond question that Korholz would not keep the 430,000 shares himself as on June 25 only the formality of Gypsum's payment remained. DX 37 Tr 240-42, 527-29.

43. On or about June 24, 1965 Defendant Korholz signed a Form 3 indicating that he was beneficial owner of 430,000 shares of Susquehanna common stock. In all probability the Form thus signed by Defendant Korholz was filed with the SEC on or about June 30, 1965. PX 24A, 24B, 24C, 52, Tr 277-79. In signing the said Form 3 for the purpose of filing with the SEC, Korholz had no intention of representing or admitting that he had acquired the 430,000 shares of Susquehanna stock, other than as an agent or nominee or intermediary acting on behalf of Gypsum. At the time Defendant Korholz signed the said Form 3, on or about June 24, 1965, he knew that he had acquired the 430,000 shares of Susquehanna stock on behalf of Gypsum, for a temporary period, and he knew that the formalities of placing the record ownership of such stock in Gypsum were scheduled to be completed within a few days. DX 65B. Defendant Korholz did not know, that under the SEC regulations a disclaimer could be attached to the said Form 3, in order to state facts indicating that Section 16(b) was not applicable to the transaction. Tr 331, PX 24.

44. One of the members of the Lannan group to whom the May 13, 1965, offer was made was out of the United States and arrangements could not be made for this individual, Wheelock Whitney, to deposit his Susquehanna shares with the Bank within the time period contemplated by Korholz's offer. Tr 254, 877. Therefore, Korholz offered on May 18, 1965, to purchase Mr. Whitney's 25,000 shares,

the offer to remain standing until August 21, 1965, when it could be accepted. Tr 255, 877, PX 17A.

45. Korholz's offer was accepted by Mr. Whitney and in August, Tr 255, 877, PX 17B, Korholz together with an associate, Samuel Ferguson, purchased 25,000 Susquehanna shares at $15.00 per share for a total of $375,000. PX 17C, PX 17D.

46. Although Wheelock Whitney's 25,000 Susquehanna shares were part of the original transaction between the Lannan group and defendant Korholz none of these shares were conveyed to Gypsum; PX 26B, 12,500 shares were retained by defendant Korholz and 12,500 shares were retained by Samuel Ferguson. Tr 879.

47. The Bank loaned $375,000 to defendant Korholz and Mr. Ferguson in connection with the Whitney shares, said loan representing the full amount of the purchase prices. DX 93, PX 17D, PX 63A.

48. On July 2, 1965, Korholz sold 430,000 shares of Susquehanna capital stock to Gypsum for the sum of $6,499,028.96, being equivalent to $15.114 per share. Tr 711-12, 716, 719, 797, PX 25D, PX 32, PX 54, PX 65A, PX 67A, PX 67B, PX 67C, PX 67D, PX 72, DX 68, DX 65B. That sum was based upon the initial purchase price paid by Korholz, escrow fees, transfer taxes and interest due on the Bank loan to Korholz until July 2, 1965. PX 32, PX 66, DX 68.

49. On July 2, 1965, Gypsum borrowed $6,450,000 from the Bank the proceeds of which were used to acquire the Susquehanna shares from Korholz. PX 22B (Item 8), DX 68.

50. Payment was made by Gypsum to Korholz for the Susquehanna shares by substituting the Gypsum promissory note to the Bank for Korholz's promissory note. The Bank thereafter discharged Korholz from his obligation on July 6, 1965 after payment to the Bank by Gypsum of $49,028.96, PX 5A (p. 2), PX 32, DX 48, 79, Tr 702-09.

51. Just as a technicality, the Bank set July 2 as the payment date, or date for the switchover of the Korholz and Gypsum notes and so advised the Treasurer of Gypsum. PX 32, DX 65A, Tr 273-74. The Treasurer of Gypsum, was not a Director of the Corporation and had no authority to enter into an agreement on behalf of Gypsum to buy the 430,000 shares of Susquehanna stock from Korholz on July 2. DX 65A, Tr 273-74, 773.

52. There was no agreement between Gypsum and Korholz about a purchase and sale by Korholz to Gypsum on July 2, Korholz did not authorize anyone to represent him at a "closing" on July 2 and did not know that any closing took place on July 2. Tr 286-289, 293.

53. Mrs. Korholz did not participate in these transactions other than by signing a pledge of her stock as security for the Korholz note of May 20 and the Gypsum note of July 2, Tr 64, 126-27, DX 79.

54. Early in August, 1965, a Form 4 for July, 1965, listing changes in ownership during the month of July, was filed on behalf of Defendant Herbert F. Korholz. The said Form 4 was not signed by Defendant Korholz and he had no knowledge concerning preparation or execution of the said Form 4. The said Form 4 was signed for Defendant Korholz by J. Carney, his secretary. PX 25D, Tr 277-280, 901-03, 884-85. There is no evidence that Mrs. Carney, secretary to Mr. Korholz, knew in 1965 that under the SEC regulations a disclaimer could be attached to the said Form 4, in order to state further facts indicating that Section 16(b) was not applicable to the transaction. Tr 874, PX 25D.

55. On August 10, Gypsum filed with the SEC Form 8K, which stated:

> On July 2, 1965, the registrant purchased from H. F. Korholz and Martha Korholz, his wife, 430,000 shares of common stock of the Susquehanna Corporation for a total consideration of $6,499,028.96...

> The purchase by the registrant for the foregoing consideration had, prior to the acquisition of such stock by Mr. & Mrs. Korholz, been approved by the Board of Directors of the registrant, provided that Massachusetts Mutual Life Insurance Company and State Mutual Life Assurance Company would consent to such purchase. Each of the foregoing companies gave its consent on June 9, 1965. . . . PX 54.

In September, 1965 Susquehanna filed with the SEC its Form 8K indicating that as of June 30, 1965 H. F. Korholz "beneficially owned" 430,000 shares of Susquehanna stock. These said Form 8Ks were filed, not pursuant to Section 16 of the Securities Exchange Act of 1934, but pursuant to another provision of that statute.

56. On October 19, 1965, Gypsum and Susquehanna by action of its respective Board of Directors entered into an agreement whereby Gypsum would be merged into Susquehanna. Tr 842, PX 23.

57. At the meetings of the stockholders of Susquehanna and Gypsum held, respectively, on December 7 and December 10, 1965, the merger was approved. Tr 846-48, 851-52, 862, PX 23, PX 30M, PX 22D, DX 99A.

58. The "effective date" of the merger was December 13, 1965, Tr 843, PX 300, and by virtue of the terms of the merger agreement the Korholz defendants on that date acquired the following number of Susquehanna shares, Tr 116, PX 27C, PX 27, PX 27B, PX 88 (p. 43), PX 23 (p. 40), PX 27A:

Herbert F. Korholz	386,102
Martha Korholz	140,171

59. On December 13 Susquehanna and Gypsum were merged on the basis of one Susquehanna share for each 1.9 shares of Gypsum. DX 99, 115, 116.

60. On the 13th of December Susquehanna shares were selling for $13 to $13 3/8 on the over-the-counter market. Tr 554, 933, 957. The Susquehanna Board of Directors on December 17 adopted a resolution fixing $13.13 as the price

of each Susquehanna share in determining cash payment in lieu of fractional shares. PX 300.

61. As of December 13, Gypsum shares were selling for an average price of $6.875 on the over-the-counter market. Tr 554-59, 930-35, 957.

62. Shortly prior to December 13, Korholz was offered by an investment company $8 a share for all the Gypsum stock he owned. Tr 560, 564-65. At $8 per share, 1.9 shares of Gypsum stock would be worth $15.20.

63. The Korholz owned 56.7% of Gypsum's shares, and thus Korholz stock was control stock. DX 121. Since the Korholz family owned more than 50% of the Gypsum stock, Defendant Korholz had absolute control and such control commands a higher premium than a minority block of stock, which ordinarily would represent effective control. Tr 576-577.

64. On December 13 control shares of Gypsum, such as Mr. Korholz had, were reasonably valued at a premium of 20% over the fair market value of similar shares of Gypsum. Tr 564-65, 905-06. At a premium of 20% over the fair market value of $6.875, a control share was reasonably valued at $8.25. Tr 556. Since the merger involved an exchange of 1.9 shares of Gypsum for each share of Susquehanna, the consideration given up by Mr. Korholz when he exchanged his Gypsum stock was reasonably valued at $15.68 per share of Gypsum stock. Tr 557. He. The fair market value of 1.9 Gypsum control shares on December 13 was approximately $15.68.

65. The stock Korholz exchanged for Susquehanna in the merger was worth at least $15.11 per share on December 13, 1968.

66. From May 12 on, it was the intention of all persons involved in this transaction to acquire the Lannan group's 430,000 shares of Susquehanna for Gypsum. Korholz found an opportunity that would benefit his corporation, Gypsum and its shareholders, he presented the opportunity to his

corporation, and he aided Gypsum to acquire the opportunity by lending his personal credit, i.e., by delivering his personal note for $6,450,000, with his stockholdings as collateral. Korholz from the beginning presented the matter as an excellent opportunity for corporate growth by Gypsum. Tr 223, 613, 730-31, 760-61, 773, DX 12A. Korholz understood that he had acquired the Susquehanna stock "on behalf of Gypsum." Tr. 224. He never intended to own the Susquehanna stock, except as a stop-gap measure until Gypsum obtained the insurance company consents that the Bank insisted upon. Tr. 260. Korholz felt that this was Gypsum stock. Tr. 416. Korholz understood that the resolution of May 12 meant that he would hold the Susquehanna stock on behalf of Gypsum until the attorneys for the insurance companies prepared the consents. Tr. 50. It is clear from all the evidence that from conception until consummation all connected with this transaction had only one purpose, that is to acquire 430,000 Susquehanna shares for Gypsum as a prelude to the merger of Susquehanna and Gypsum. DX 12A, 13, 15; 17, Tr 343, 486, 975-76. There is no evidence that Korholz intended to purchase and own these 430,000 shares personally, nor did any person connected with this transaction ever intend that Korholz personally purchase or own these shares.

CONCLUSIONS OF LAW

1. This Court has jurisdiction over the subject matter of this cause by virtue of § 27, Securities Exchange Act of 1934, and the parties hereto.

2. The plaintiff and Intervening Plaintiff having asserted claims based upon § 16, Securities Exchange Act of 1934, have fulfilled all prerequisites required thereby and by law for the bringing of such actions or have proven the futility thereof or legal excuse therefor.

3. This action is not collusive to confer jurisdiction upon this Court.

4. On July 2, 1965 and thereafter for all times relevant hereto, shares of capital stock of Susquehanna were registered pursuant to § 12g, Securities Exchange Act of 1934, its sole, non-exempt, equity security.

5. For purposes of application of the Securities Exchange Act of 1934, Korholz is the beneficial owner of the shares held by Martha Korholz in Gypsum and Susquehanna and in the Mary Lou Korholz custodian account.

6. The purchase of 430,000 shares of Susquehanna stock in May, 1965, was accomplished by Herbert F. Korholz for Gypsum and on behalf of Gypsum.

7. There was no sale of the 430,000 shares of Susquehanna stock on July 2 between Korholz and Gypsum within the meaning of Section 16(b) of the Securities Exchange Act of 1934.

8. Plaintiffs have not sustained their burden of proving that Korholz sold 430,000 shares of Susquehanna stock on July 2 within the meaning of Section 16(b) of the Securities Exchange Act of 1934.

9. July 2 was merely a payment date for the stock acquired pursuant to the May 12 resolution of Gypsum.

10. While the defendants did not contest that the merger of Susquehanna and Gypsum on December 13 amounted to a "purchase" by the Korholz defendants of in excess of 442,000 shares of Susquehanna stock within the meaning of Section 16(b) of the Securities Exchange Act of 1934 in light of *Securities and Exchange Commission v. National Securities, Inc.*, 393 U.S. 453 (1969), we do not find it necessary to so hold since we have found that there was no Section 16(b) sale and moreover when the various transactions are viewed as a whole there was no "sale" and "purchase" within six months within the meaning of the Section.

11. In their Complaint, Plaintiffs pleaded that in August 1965 Defendant Korholz had made a purchase from Wheelock Whitney of 12,500 shares of Susquehanna stock. No attempt was made to amend the pleadings in this respect, and Plain-

tiffs maintained the foregoing theory until the close of the trial herein. At the end of the trial Plaintiffs set forth a new theory in respect to this transaction, namely, that in August 1965 Korholz had acquired 25,000 shares of Susquehanna stock from Whitney and immediately thereafter had made a "sale" to Samuel Ferguson of 12,500 shares. Defendants were taken by surprise and had no reasonable opportunity to defend against this new theory. Even had such a purchase and sale occurred there was no profit to the Korholz defendants involved in these transactions.

12. No liability under Section 16(b) arises from the purchase by Korholz of 12,500 Susquehanna shares from Whitney in August 1965, because he did not make a "sale" of Susquehanna stock within a period of less than six months prior to or subsequent to such purchase.

13. Mrs. Korholz made no Section 16(b) "sale" of Susquehanna stock and no liability can attach to her under Section 16(b).

14. None of the transactions, as aforesaid, occasioned "profit realized" within the meaning of Section 16(b) to Herbert F. Korholz or to Martha Korholz.

15. These transactions, while they could be construed as falling within the literal provisions of the Act when given its broadest interpretation, will not be so characterized in light of the factual situation as developed in this case when set against the corrective purposes and rationale of Section 16(b). Not only was there no possibility of insider abuse occurring on short swing trading in this case, there was none.

ENTER: /s/ Alexander J. Napoli

UNITED STATES DISTRICT JUDGE

DATED: June 10th, 1969

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No. 71-804

In the

Supreme Court of the United States

OCTOBER TERM, 1971

GABRIEL WOLFF,

Petitioner,

vs.

HERBERT F. KORHOLZ, MARTHA KORHOLZ and THE SUSQUEHANNA CORPORATION,

Respondents.

SUPPLEMENTAL AND REPLY BRIEF

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SUPPLEMENTAL AND REPLY BRIEF

The need for review of the decision below is now made even more evident by reason of an inconsistent position with respect thereto taken by the court below on January 18, 1972 in *Dasho* v. *Susquehanna Corporation, et al,* No. 18572, United States Court of Appeals for the Seventh Circuit. The opinion (attached hereto) in that case, also written by Judge Stevens,[1] again considered the valuations of American Gypsum and Susquehanna stock in connection with the merger of the former into the latter on December

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[1] The court below in the instant case consisted of Judges Stevens, Fairchild, and Kiley. In *Dasho*, the court below was made up of Judges Stevens, Fairchild, and Cummings. Counsel representing respondent Korholz here also represented him in *Dasho*.

13, 1965. It was that very same transaction (purchase) which petitioner claimed gave rise to respondents' short swing profit when they exchanged their American Gypsum stock for Susquehanna shares.

In support of that claim and in order to prove Section 16(b) profit, petitioner at the trial relied on two appraisals of the shares of Gypsum and Susquehanna made by two experts, New York Hanseatic Corporation and Stone and Webster Corporation, at the request of respondent Korholz for use in connection with his controlled merger of Gypsum and Susquehanna. Those appraisals were introduced, over objection, in evidence by petitioner and evaluated Susquehanna shares at $10.75 and Gypsum shares at $5.65 resulting in the 1.9 to 1 exchange ratio agreed to by the parties to the merger, including respondents. The trial court never considered these appraisals despite their admission into evidence. In fact, it completely ignored them as shown by its findings of fact (Appendix to Respondents' Brief in Opposition to Petition for Certiorari). Instead, it fixed the value of over 430,000 of Gypsum shares on the effective date of the merger by relying on averages taken from over-the-counter quotations on 100 shares of Gypsum to which it added a 20% premium for control. The serious errors involved in such limited evaluation and their effect on enforcement of Section 16(b) liability have already been pointed out by petitioner (Petition for Certiorari, pp. 7-15).

Despite petitioner's contentions as to these errors in the court below, that court affirmed and approved the trial court's method and circumscribed formula of evaluation, held that the *market value* of Korholz's American Gypsum shares was to be *exclusively* used to determine short swing profits (Petition for Writ of Certiorari, Appendix, p. 6a, ftn. 3), and placed its imprimatur on the trial court's failure to even consider the "going concern" value of Gyp-

sum shares as shown by respondent's New York Hanseatic Corporation and Stone and Webster Corporation appraisals. The court below has thus as a matter of res judicata (unless the petition here is granted) established as between Susquehanna on the one hand and American Gypsum stockholders (including respondents) on the other a market value of $6.875 per share of Gypsum stock for exchange purposes in the merger.[1]

In Dasher the court below ignored the res judicata effect of its decision in the instant case[2] and held that the trial court's finding in that case of an evaluation of American Gypsum at $6.65 per share (as fixed by the appraisals heretofore referred to) was "not clearly erroneous" and it intimates quite broadly it would enter the same finding based on the appraisals ignored in the case at bar. In this connection, the court below stated, slip opinion, p. 23:

> "The district court found that the exchange ratio was fair. All the directors so testified, and plaintiffs offered no expert testimony to the contrary. The finding is further supported by the opinions of *New York Hanseatic Corporation and Stone and Webster. Even though the finding is not clearly erroneous, indeed even if we would enter the same finding ourselves*, it does not follow that the record contains no evidence from which a jury might have come to a different conclusion." (Emphasis added.)

Despite its apparent acceptance of $6.65 as a proper evaluation of Gypsum stock, the trial court, however, decided (for remand purposes) that a jury might find that

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[1] The necessity of adding a 20% control premium to this market value exclusively for Kalbfell has already been pointed out. (Petition for Certiorari, pp. 10, 11).

[2] There is no question as to mutuality of parties or identity of issues.

even $5.65 was *too high* a value and thus conclude that Susquehanna had been fraudulently induced to accept "an inadequate price per share." As to this, the court below stated, slip opinion, p. 23:

> "Nevertheless, it is possible that the terms of the merger may have damaged Susquehanna. Even if it was wise to sell its shares to obtain Gypsum's earnings, Susquehanna may have been fraudulently induced to accept an inadequate price per share and therefore to issue too many shares.
>
> "For purposes of analysis we may assume that Susquehanna sold its own shares for a price of $10.75 per share and purchased Gypsum shares for a price of $5.65 per share. If either the former price was too low, or the latter price was too high, and if no compensating adjustment in the other is appropriate, Susquehanna was damaged. In other words, if the exchange ratio was unfair to Susquehanna, it was injured by the merger."

The ambivalence of the court below with respect to the evaluation of American Gypsum stock as demonstrated in the case at bar and in *Dasho* is evident. The complete disregard of the experts' appraisals of that stock in the former when contrasted with the weight accorded them in the latter is startling. Had the court below in the instant case applied the same valuation tests it approved in *Dasho,* reversal of the trial court would necessarily have followed. The use by the court below without justification of separate standards of evaluation in cases involving the same stock and transaction indicates it has so far departed from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

Furthermore, it seems obvious that the double standard of evaluation as applied in this case and in *Dasho* can only impede the effective enforcement of Section 16(b). What

insider would not arbitrarily choose that evaluation most advantageous to him in order to avoid liability?

In closing, petitioner notes that respondents argue that there was no violation of Section 16(b) in the first place. In this connection they state that the court below *concurred* in the finding of the trial court that there was no "sale" of Susquehanna shares within the meaning of that Section. (Brief for Respondents in Opposition, p. 5.) This is not so. The court below never so decided or concurred and decided this case on the assumption that there had been such a violation.

CONCLUSION

We believe that the matters hereinbefore set out as well as those argued in our original petition require review by this Court of the decision below. In the event the petition here is denied, it is respectfully suggested that in the interest of consistency of opinions emanating from the same Circuit, that this case be remanded to the court below with directions to reconsider its opinion in the light of its subsequent decision in *Dasho*.

Respectfully submitted,

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In the

United States Court of Appeals

For the Seventh Circuit

SEPTEMBER TERM, 1971 — SEPTEMBER SESSION, 1971

No. 18572

WILLIAM DASHO, DASHO-ROGERS, INC. and MAURICE H. SCHY,
Plaintiffs-Appellants,
vs.
THE SUSQUEHANNA CORPORATION, RALPH A. L. BOGAN, JR., EDWARD O. BOSHELL, M. M. HARDIN, HERBERT F. KORHOLZ, J. PATRICK LANNAN, HOWARD J. LAUHOFF, A. D. MARTIN, J. EARLE MAY, HUGH C. MICHELS, AKSEL NIELSEN, D. W. REEVES, R. G. SCHENK, FRANKLIN B. SCHMICK, HAROLD C. STUART, ALBERT W. THOMSON, FRANCIS C. WOOLARD and AMERICAN GYPSUM CO.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 65 C 1757

Hon. ABRAHAM L. MAROVITZ, *Judge.*

JANUARY 18, 1972

Before FAIRCHILD, CUMMINGS and STEVENS, *Circuit Judges.*

STEVENS, *Circuit Judge.* American Gypsum Company was merged into Susquehanna Corporation on December 13, 1965. Plaintiffs, as shareholders of Susquehanna, commenced this action in advance of the merger for the purpose of preventing its consummation and also to recover

damages for Susquehanna and its pre-merger shareholders. The district court refused to enjoin the merger and dismissed Count I of the complaint which asserted claims under § 17(a) of the Securities Act of 1933[1] and § 10(b) of the Securities Exchange Act of 1934.[2] Proceedings under Count II, which asserted that the pre-merger proxy solicitation violated § 14(a) of the 1934 Act,[3] were apparently stayed pending the appeal to this court from the dismissal of Count I.

Count I alleged that Susquehanna had been harmed not only by the merger but also by an earlier purchase of 222,107 of its own shares at an excessive price. We held that the allegations of fraud or deception in connection with each of these securities transactions were sufficient to state a federal claim under § 17(a) and § 10(b). *Dasho* v. *Susquehanna Corporation*, 380 F.2d 262 (7th Cir. 1967), *cert. denied*, 389 U.S. 977.

Following the remand, there were protracted proceedings in the district court. Count II of the complaint was reinstated, defendants answered, portions of their answers were stricken, extensive discovery was conducted, plaintiffs' request for a jury trial was denied, they amended their complaint, plaintiffs voluntarily dismissed three defendants, the court held a lengthy trial, and thereafter plaintiffs filed still another amended complaint to conform their final theories of the case to the proof. In that pleading they abandoned all charges of conspiracy.

The district court entered extensive findings of fact, conclusions of law, and judgment for the defendants on all claims. On this appeal plaintiffs contend that it was error to strike their jury demand, that the district court misconceived their theory of the case, that critical findings are clearly erroneous, and that vital evidence was improperly excluded. The threshold question is whether *Ross* v. *Bernhard*, 396 U.S. 531, which was decided by the Supreme Court after the trial was concluded, requires us to hold that it was error to deny plaintiffs a jury trial. Since we have concluded that it does, we must also identify the issues

[1] 15 U.S.C. § 77q.
[2] 15 U.S.C. § 78j.
[3] 15 U.S.C. § 78n.

which should be submitted to a jury for determination when the case is remanded for a new trial.

Before discussing the legal issues, we shall identify the defendants and describe the three securities transactions which gave rise to plaintiffs' derivative action.

I.

Susquehanna is a large publicly owned corporation. In April and May of 1965 its shares were traded over the counter in the range between a low bid of 11-½ and a high asked price of 14-⅛. At the time of its annual meeting on April 19, 1965, approximately 2,760,000 shares were outstanding, owned by some 8,750 stockholders. At that meeting 15 directors were elected, 13 proposed by management and 2 by a group in Kansas City who had cumulated their votes to oppose the management slate. The 13 management directors, led by J. Patrick Lannan, the chairman of the board, owned or controlled about 436,000 shares; however, substantial additional amounts of Susquehanna stock were owned by friends or associates of the 13 management directors and by the Kansas City group represented by the two dissidents.

Prior to May 25, 1965, neither American Gypsum Company, over half of whose shares were controlled by defendant Herbert F. Korholz, nor Korholz himself, owned any Susquehanna stock. After consummation of the three transactions which plaintiffs challenge, Korholz had become Susquehanna's principal shareholder, and the management directors, as well as the Kansas City group, had sold a major portion of their holdings.

On May 25, 1965, Korholz purchased 430,000 shares from Lannan, certain management directors, and their friends and relatives at a price of $15 per share. On August 11, 1965, in a transaction negotiated by Korholz, Susquehanna purchased 222,107 of its own shares from the Kansas City group at a price of either $13.85 or $10.78 per share, depending on whether plaintiffs' or defendants' version of the transaction is accepted. On December 13, 1965, to consummate the merger with Gypsum, Susquehanna issued 1,274,734 shares to the former shareholders of Gypsum, including Korholz, in an exchange which was based on a determi-

nation that Susquehanna's stock had a fair value of $10.75 per share. One of the assets acquired by Susquehanna via the merger was the block of 430,000 of its own shares which Korholz had purchased from Lannan and thereafter conveyed to Gypsum; one of the liabilities was the bank indebtedness of $6,450,000 which Gypsum had incurred to finance the 430,000 share purchase.

The defendants may be identified in four groups: The Lannan defendants who sold out and resigned from the board in May or shortly thereafter;[4] the eight members of Lannan's board who remained as directors and shareholders after he sold out;[5] the two dissidents representing the Kansas City group;[6] and Korholz and his associates.[7] Since plaintiffs' conspiracy charge has been abandoned, the different defendants obviously do not share equal responsibility for each of the three transactions which took place on May 25, August 11, and December 13, 1965. Although these transactions were not unrelated, we shall describe them separately.

1. The purchase of 430,000 shares by Korholz on May 25, 1965, was the consequence of discussions between Korholz and representatives of Lannan earlier that month. The price of $15 per share was about $3.00 over the market when it was agreed upon, subject to certain conditions. Korholz's offer was conditioned upon the resignation of five members of the Susquehanna board, including Lannan,

[4] Lanhan, Lauhoff and Wirtz resigned from the board on May 18, 1965, and sold all of their Susquehanna stock a week later. Schmick and Bard also sold all of their stock but did not resign until June 18 and July 15, respectively. Wirtz and Bard were voluntarily dismissed by plaintiffs on the first day of trial; Lannan, Lauhoff and Schmick contend that they have no responsibility for what happened after their resignations from the board.

[5] Schenk, Bogan, Boshell, May, Michels, Stuart, Mason and Woolard were members of Lannan's management slate and remained on the board, and continued to own Susquehanna stock until after the merger. Mason owned only 100 shares; he was the third defendant voluntarily dismissed by plaintiffs.

[6] Martin and Thomson were the two directors elected by a group of shareholders who were apparently customers of a broker in Kansas City named Coen. They had no advance knowledge or participation in the original sale of 430,000 shares to Korholz, but were familiar with the transaction with Coen in August and the merger in December.

[7] Korholz is the principal defendant. Hardin, Nielsen and Reeves were his nominees to replace the members of the Lannan management who resigned on May 18, 1965, or shortly thereafter. Gypsum, the corporation of which Mr. and Mrs. Korholz owned or controlled 57% before its merger into Susquehanna, is also a defendant.

the election of Korholz as chairman of the board of directors and as a member of the Executive Committee, and the election of two Korholz nominees (Nielsen and Hardin) to the Susquehanna board.

The offer was communicated to all 13 management directors, but not to the two dissidents or to the public. The five directors who were to resign sold their Susquehanna stock; the remaining directors made significant contributions to the 430,000 share package, either from their own holdings or from stock owned by friends and relatives,[8] but each retained an investment in Susquehanna.[9] Before they voted to elect Korholz, Nielsen, and Hardin to the Susquehanna board, the remaining directors had been advised about the business experience and integrity of the new directors and presumably also knew that the sale of the 430,000 shares at the $15 price was contingent upon their election.

The district court found, however, that the old directors were not aware of the fact that Korholz was making the purchase on behalf of Gypsum rather than as an individual investment. He made the offer and closed the transaction in his individual capacity because Gypsum was disabled from obtaining the necessary financing without the consent of two insurance companies to which it owed several million dollars. Korholz had received informal assurance that such consents would be forthcoming and, therefore, had been able to borrow $6,450,000 from The First National Bank of Boston on the understanding that Gypsum would assume that indebtedness and acquire the 430,000 shares of Susquehanna as soon as conditions specified by the insurance companies had been met. Those conditions included the election of Korholz as chairman and two of his designees as members of Susquehanna's board of directors, and an assurance from Gypsum that if it were merged into Susquehanna, the merged company would promptly repay the bank loan of $6,450,000.

[8] Thus, for example, Bogan, who owned or controlled 56,152 shares at the time of the annual meeting in April, delivered about 65,000 shares into the package and still retained 13,986 shares on September 15, 1965, according to the proxy statement. Woolard, who retained his own holding of 16,800 shares, sold approximately 70,000 shares for his associates.

[9] Seven of the remaining directors owned a significant number of shares after the Korholz purchase, ranging, at the time the proxy statement for the merger was prepared, from 64,229 for Michels and 47,260 for May, to 2,147 for Schenk, the company president.

It is apparent that Korholz, Gypsum, and The First National Bank of Boston were conscious of the fact that Susquehanna's current assets exceeded its total liabilities by over $13,000,000 when the funds to finance the 430,000 share purchase were advanced. The management directors of Susquehanna apparently knew little more than that Korholz, a capable and imaginative executive, was prepared to pay a premium price of $15 per share for about 15% of Susquehanna's stock and to accept a position of major responsibility in the direction of the corporation's affairs.

Precisely what public announcement of the transaction was made is not clear from the record. The district court found that "when the information as to facts was publicly released promptly after the May 18 board meeting, there was no effect whatsoever on the price of Susquehanna in the over-the-counter market."

The first transaction resulted in a significant change in the ownership of Susquehanna's stock and in the composition of its management, but it had no direct impact on the corporation's assets, liabilities, or capital structure. The balance sheet of Gypsum, however, was materially affected as soon as the arrangements to finance the purchase price had been concluded. It acquired a $6,450,000 asset, consisting of the block of 430,000 shares of Susquehanna, and a new liability of an equivalent amount, represented by the bank loan. Gypsum retained this asset and this liability until it was merged into Susquehanna in December.

2. In the second transaction which was closed on August 11, 1965, Susquehanna acquired 222,107 of its own shares and $300,685 in cash in exchange for 140,000 shares of the stock of Vanadium Corporation of America which Susquehanna had owned for four or five years. The transaction was closed through an escrow at The First National Bank of Boston in which three parties, Susquehanna, M. Coen, representing the Kansas City group, and Vanadium, all made deposits and withdrawals.

Vanadium deposited $3,377,500 in cash and withdrew 140,000 of its own shares;[10] Coen, on behalf of the Kansas

[10] It promptly sent a letter to its shareholders reporting that it had made a favorable purchase of those shares at a price of $24.125 per share, a price which, though over the current market, was less than book value.

City group, deposited 222,107 shares of Susquehanna stock and made a net cash withdrawal of $3,076,815; Susquehanna deposited the 140,000 shares of Vanadium and withdrew the 222,107 shares of Susquehanna deposited by the Kansas City group and the cash balance of $300,685.

Three versions of this transaction have been put forward by the parties, one by the plaintiffs and two by the defendants.

Plaintiffs contend that Vanadium's payment of $3,377,500 established the value of the block of 140,000 of its shares, and that a simple calculation of the Susquehanna and Coen deposits and withdrawals reveals a purchase by Susquehanna of a block of its own shares for a price of $13.85, or a premium of about $3 over the market.[11]

Defendants contend that Susquehanna simply exchanged its block of Vanadium stock for 222,107 Susquehanna shares owned by the Kansas City group, and that the resale of the Vanadium stock for cash was a separate transaction to which Susquehanna was not a party. On the day before the exchange agreement was executed, the mean price for Susquehanna in the over-the-counter market was almost $11, and Vanadium closed at $19.25; the exchange agreement was predicated on a trade of 140,000 shares of Vanadium at $19.25 each (a total package of $2,695,000) for 250,000 shares of Susquehanna at $10.78 each, with a pro rata cash adjustment to be made if a lesser quantity of Susquehanna shares should be delivered.[12] Thus, under defendants' first version of the transaction, it was simply an exchange of shares on a market-to-market basis, without any premium attached to either block. In essence, this is the version of the transaction which was reported to Susquehanna's shareholders in the pre-merger proxy statement. Consistently with this interpretation, no disclosure was made of the resale of the Vanadium shares at a price of $24.125, which netted the Kansas City group a premium of $682,500. Defendants contended that such a premium could not have been realized in any sale by Susquehanna

[11] The net amount received by the Kansas City group ($3,076,815) divided by the number of Susquehanna shares delivered (222,107) equals a price of $13.85.

[12] Thus, the difference between the maximum purchase of 250,000 shares and the 222,107 shares actually delivered accounts for the cash distribution to Susquehanna of $300,685.

because an outstanding injunction prohibited Susquehanna from voting those shares.[13]

Plaintiffs offered evidence to prove that defendants knew, or should have known, that a premium was obtainable for the block of 140,000 shares of Vanadium, and that the premium value had been deliberately made available to the Kansas City group to forestall threatened litigation and possible opposition to a merger with Gypsum.[14]

Defendants' second version of the transaction was that the directors, acting in good faith and exercising an informed, independent business judgment, might deliberately make a premium available to the Kansas City group in order to eliminate the divisive influence on the board represented by the two dissident directors, thereby permitting Susquehanna to function more effectively and harmoniously. The two dissidents remained on the board and thereafter voted consistently with their colleagues. In substance, defendants' second interpretation of the August transaction is that if Susquehanna did, indeed, pay a premium price for the 222,107 shares purchased from the Kansas City group, a corporate benefit of equivalent value was received, or at least the directors in good faith so believed. Under this version it is not entirely clear to us whether defendants are contending that the "informed business judgment" of the directors included knowledge that a premium was being made available to the Kansas City group.

The district court entered findings proposed by defendants which appear to accept both of defendants' versions of this transaction.

3. In the merger consummated on December 13, 1965, Susquehanna in effect "sold" 1,274,734 newly-issued shares

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[13] See *Vanadium Corp. of America v. Susquehanna Corp.*, 203 F.Supp. 686, 697 (D.Del. 1962).

[14] Coen, representing the Kansas City group, addressed a letter to the Susquehanna directors threatening to commence litigation to recover the premium portion of the price received by Lannan and the other selling parties in May and to enjoin Korholz and his associates from acting as directors and from voting any of the shares purchased from Lannan. Korholz thereafter proposed the exchange of Vanadium stock for the stock represented by Coen. After the exchange was authorized by the Susquehanna board on July 15, 1965, Korholz introduced Coen to the Vanadium principals with whom he negotiated the resale. He formally withdrew his threat of litigation by letter of August 10.

favorable to Gypsum,[17] but in the first four months of 1965 it would have been somewhat more favorable to Susquehanna, ranging between 1.92 to 1 and 2.02 to 1 during those months.

The experts took note of the fact that one of Gypsum's major assets was its ownership of 430,000 shares of Susquehanna stock. Those shares were carried on Gypsum's books at their cost of $6,450,000 (or $15 per share). With its investment in Susquehanna valued at cost, Gypsum's stock had a book value of $2.20 per share, as reported in the proxy statement. Since, however, the experts had appraised Susquehanna stock as worth only $10.75 per share (as compared with the $15 cost on Gypsum's books), they recognized that the value of Gypsum's ownership of 430,000 Susquehanna shares should be reduced by $1,827,500 (430,000 times $4.25 per share), and that such an adjustment would reduce the Gypsum stockholders' equity to about $3,984,000,[18] or approximately $1.53 per share. This adjustment, as well as Gypsum's heavy indebtedness, was a factor considered by New York Hanseatic in determining the 10% capitalization rate for Gypsum. It noted that Gypsum stock had been valued in the market "historically" at 13 to 18 times earnings, and, therefore, the multiple of 10 was considered appropriate.[19]

The two companies distributed a joint proxy statement, as well as a series of supplementary letters, in which they reported that the directors of both companies unanimously favored the merger. In essence, Susquehanna was contributing a strong balance sheet and a large tax loss, and Gypsum was contributing earnings potential, to a mutually beneficial combination. The proxy statement reported the conclusions of New York Hanseatic and Stone and Webster, but omitted any explanation of the basis of the experts' evaluations.

[17] Thus, for example, in January of 1964 the ratio would have been 1.15 to 1, and in July of 1965, 1.62 to 1.

[18] The experts' opinion does not give complete details on how this figure was arrived at, but we accept it as accurate enough for our purposes.

[19] They made no comment on the fact that the conservative multiple of 10 times the adjusted earnings of 56-½ cents produced a higher value than a liberal multiple of 17 times the audited earnings of 33 cents per share.

Plaintiffs contend that the proxy statement omitted, or inaccurately stated, a number of material facts. They criticized the descriptions of the original Korholz purchase, of the purchase from the Kansas City group, and of the extent of Korholz's control over the management of the company and the planning of the merger.

The merger was approved by the shareholders of both companies; 97% of the shares of Gypsum were voted affirmatively in favor of the merger and 75% of the shares of Susquehanna. Thus, over 200,000 votes more than the required 66-2/3% of the Susquehanna votes needed for approval were obtained. Approximately 25% of the shares either did not vote or voted against the merger.

II.

Defendants contend that plaintiffs were not entitled to a jury trial because (a) *Ross* v. *Bernhard*, 396 U.S. 531, which was decided on February 2, 1970, announced a new rule of constitutional law that is inapplicable to the trial in this case which was concluded on October 22, 1969; (b) plaintiffs' jury demand was not timely; and (c) in any event it related to only three of the 18 defendants. We have concluded that none of these arguments is supportable.

A.

To support their contention that *Ross* v. *Bernhard* does not apply retroactively, defendants rely on *DeStefano* v. *Woods*, 392 U.S. 631. In that case the Supreme Court held that the decisions in *Duncan* v. *Louisiana*, 391 U.S. 145, and *Bloom* v. *Illinois*, 391 U.S. 194, would not be applied retroactively. In *Duncan* and *Bloom*, the Court had upheld a defendant's right to a jury trial in serious criminal cases, including criminal contempts. The argument here is that if the constitutional right to a jury trial is not enforced retroactively in cases involving personal liberty, *a fortiori*, there should be no retroactivity in litigation involving mere property rights.

The argument implies that nonretroactivity should have broader application in civil than in criminal litigation. In fact, however, "the nonretroactive application of judicial decisions has been most conspicuously considered in the

area of criminal process." *Chevron Oil Co.* v. *Huson*, 40 U.S.L.W. 4023, 4026 (Dec. 6, 1971). There is almost no suggestion in any of the cases from *Linkletter* v. *Walker*, 381 U.S. 618, through *Mackey* v. *United States*, 401 U.S. 667, (see especially Mr. Justice Harlan's concurring opinion, 675-702) that this line of authority should be applied to civil litigation. Nevertheless, there are instances in which the "doctrine of nonretroactivity" has been applied in civil litigation. *Chevron Oil Co.* v. *Huson*, *supra*, at 4026.

In dealing with the nonretroactivity question, the Supreme Court has generally considered three separate factors. The first, which we consider decisive here, is whether the rule sought to be applied establishes "a new principle of law either by overruling clear past precedents on which litigants may have relied . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed." 40 U.S.L.W. 4026. In this case defendants' argument assumes that *Ross* v. *Bernhard* announced a new rule of procedure because there was no preexisting right to a jury trial in derivative litigation. This position was persuasively advanced by the majority of the Second Circuit in the opinion on which the court below relied,[20] and by Mr. Justice Stewart in his dissent in *Ross*, 396 U.S. 531, 543-551. We think it plain, however, that we must follow the rationale of the Supreme Court's majority opinion which merely held, in agreement with a 1963 decision of the Ninth Circuit,[21] that "the Seventh Amendment preserves to the parties in a stockholder's suit the same right to a jury trial that historically belonged to the corporation and to those against whom the corporation pressed its legal claims." 396 U.S. at 542. Under the analysis made in the Supreme Court's majority opinion, *Ross* did not establish a new principle of law. It merely resolved a conflict in the circuits consistently with the Court's interpretation of prior law.

The second factor in deciding the retroactivity question is whether, weighing the merits and demerits in each case, retrospective application will further or retard operation of the rule. The third requirement is that we weigh the possi-

[20] *Ross* v. *Bernhard*, 403 F.2d 909 (2nd Cir. 1968), but see Smith, C.J., dissenting at p. 915.

[21] *DePinto* v. *Provident Security Life Ins. Co.*, 323 F.2d 826, cert. denied, 376 U.S. 950.

ble inequities of retroactive application. Since there were conflicting rules in the circuits, the defendants knew that the issue was not settled and that the district court might be reversed on appeal. They were certainly aware of the Ninth Circuit's decision in the *DePinto* case, as well as the fact that a member of the Second Circuit panel in *Ross* v. *Bernhard* had filed a dissenting opinion. It is, therefore, no more inequitable here than in any other case presenting an unsettled question of law to require defendants, who could have avoided the issue by consenting to a jury trial, to bear the risk of reversal on appeal. Moreover, our appraisal of the disclosures pertaining to the exchange of 140,000 shares of Vanadium Corporation stock for 222,107 shares of Susquehanna persuades us that it would not be inequitable to retry this case. Finally, we fail to see how retroactive application will retard operation of the rule. Thus, though we consider the first criterion decisive, we have also considered and rejected any claim of nonretroactivity based on the second and third criteria.

The basic reason for holding that a new rule will not be applied retroactively is to avoid unfairness to parties who may have acted in reliance on the old rule.[22] In this case, however, defendants do not seek to justify any aspect of their conduct of the three transactions challenged by plaintiffs by claiming reliance on a rule which antedated the Supreme Court decision in *Ross* v. *Bernhard*. Nothing more than trial tactics was involved in their motion to strike the plaintiffs' jury demand. This is not one of the exceptional situations in which a holding of nonretroactivity is required to avoid consequences akin to the enactment of an ex post facto law.

We hold that plaintiffs were entitled to demand a jury trial of any legal claims historically triable to a jury which they have asserted against defendants on behalf of Susquehanna Corporation.

B.

Defendants contend that plaintiffs' jury demand was not timely. It was filed more than 38 months after the original

[22] See Schaefer, The Control of "Sunbursts": Techniques of Prospective Overruling, 42 N.Y.U.L.R. 631 (1967); Fairchild, Limitation of New Judge Made Law to Prospective Effect Only: "Prospective Overruling" or Sunbursting, 51 Marquette L.R. 254, 257 (1967-68).

complaint and several months after all defendants had answered. It was incorporated in a reply which itself was not filed within the time specified by the court.

Defendants rely on cases holding that after the right to a jury trial has been waived, the right cannot be revived by a belated amendment to the pleadings which does not raise any new issues.[23] However, a review of the proceedings in this case persuades us that there was no point in time when it could fairly be said that plaintiffs had waived their right to demand a jury.

Rule 38(b) permits a party to postpone decision on whether or not to demand a trial by jury until after the issues to be submitted to the jury have been finally framed by the pleadings.[24] Presumably, that is the reason the timeliness of a jury demand is measured from the filing of the "last pleading directed to such issue," and also why amendments which do not really change the issues do not revive a right that has been waived.

In this case plaintiffs cannot be charged with sole responsibility for the time which elapsed before the case was finally at issue. The sufficiency of Count I of the complaint was tested by motions to dismiss which led to the first appeal to this court. After the remand, defendants filed their answers in February and March of 1968. Plaintiffs promptly moved to strike several portions of the answers, including parts of all five affirmative defenses asserted by defendants Korholz, Gypsum and Susquehanna. Those motions raised substantial questions which were briefed at length and led to the entry of an order on October 21, 1968, in which the court struck portions of the affirmative defenses and granted plaintiffs leave to file a reply by December 1, 1968. The reply was not actually filed until December 30, 1968, but no objection to its filing was made at that time.

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[23] See *Moore* v. *United States*, 196 F.2d 906, 908 (5th Cir. 1952); *Connecticut General Life Ins. Co.* v. *Breslin*, 332 F.2d 928, 931 (5th Cir. 1964); *Leighton* v. *New York, Susquehanna & Western R.R.*, 36 F.R.D. 248, 249 (S.D.N.Y. 1964).

[24] Rule 38(b) provides:

"(b) Demand. Any party may demand a trial by jury of any issue triable of right by a jury by serving upon the other parties a demand therefor in writing at any time after the commencement of the action and not later than 10 days after the service of the last pleading directed to such issue. Such demand may be indorsed upon a pleading of the party."

If the reply had been filed on December 1, 1968, quite clearly it would have been the "last pleading" within the meaning of Rule 38(b). Up to that time there had been no final definition of the issues and no waiver of the right to a jury trial. By permitting the reply to be filed on December 30, 1968, the trial court effectively extended the time for filing the "last pleading," and thus the time in which to demand a jury.

When the district court sustained the motion to strike the jury demand, he placed no reliance on its late filing. Commendably he made it perfectly clear that his ruling was based on the Second Circuit decision in *Ross* v. *Bernhard*, and he indicated at the hearing on the motion that if the law permitted a jury trial in a derivative action, he would not have rejected the demand as untimely. We hold that plaintiffs did not waive their right to a jury trial.

C.

The pleading which included the jury demand was identified as a reply to the affirmative defenses of only three of the defendants. It is, therefore, contended that the demand should be construed as limited to the issues raised in the affirmative defenses of those three defendants.

Even as so construed, however, it is clear that basic issues in the litigation were encompassed by the reply and, therefore, by the jury demand incorporated therein. The affirmative defenses squarely raised the question whether Susquehanna had been damaged by any of the alleged misconduct of the defendants, the question whether the merger exchange ratio was fair, and other important issues.

The broad language of the jury demand plainly indicated that plaintiffs wanted a jury trial of all issues which could properly be submitted to a jury. Defendants other than Korholz, Gypsum and Susquehanna construed the demand as applicable to them because they also filed a motion to strike. The trial judge viewed the problem as whether any jury trial was appropriate in a derivative action, and does not appear to have considered the possibility of separating out certain issues for the jury. We have no doubt that if the trial judge had had the benefit of the later Supreme Court opinion in *Ross* v. *Bernhard*, he would not have con-

strued the demand in the restrictive manner which defendants urge here. Assuming that the demand was timely, as we have held, we think a fair construction of its broad language would cover all issues that plaintiffs are entitled to have tried by a jury. We, therefore, must identify those issues.

III.

Although the holding in *Ross* v. *Bernhard* makes it plain that plaintiffs, who are suing derivatively on behalf of Susquehanna, have "the same right to a jury trial that historically belonged to the corporation," 396 U.S. at 542, in that case the Supreme Court was not required to define the scope of that right. The opinion recognizes the possibility that some breaches of fiduciary duty by corporate directors may not be triable to a jury;[25] the reference to history in the statement of the holding implies that claims which are traditionally regarded as equitable in character may properly be heard by the court.

It is important to state the claims asserted by plaintiffs as precisely as possible, not only because we must differentiate between legal and equitable claims, but also because the relevant law is still in an embryonic stage of development and the Supreme Court has admonished us not to stunt its growth with "glib generalizations and unthinking abstractions."[26] We shall, therefore, first consider the two claims which we held sufficient on the prior appeal and then turn our attention to the several other claims which are included in the complaint as finally amended.

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[25] "In the instant case we have no doubt that the corporation's claim is, at least in part, a legal one. The relief sought is money damages. There are allegations in the complaint of a breach of fiduciary duty, but there are also allegations of ordinary breach of contract and gross negligence. The corporation, had it sued on its own behalf, would have been entitled to a jury's determination, at a minimum, of its damages against its broker under the brokerage contract and of its rights against its own directors because of their negligence. Under these circumstances it is unnecessary to decide whether the corporation's other claims are also properly triable to a jury. *Dairy Queen, Inc.* v. *Wood*, 369 U.S. 469 (1962)." 396 U.S. at 542-543.

[26] "Although § 10(b) and Rule 10b-5 may well be the most litigated provisions in the federal securities laws, this is the first time this Court has found it necessary to interpret them. We enter this virgin territory cautiously. The questions presented are narrow ones. They arise in an area where glib generalizations and unthinking abstractions are major occupational hazards. Accordingly, in deciding this particular case, remembering what is not involved is as important as determining what is." *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 465.

For purposes of identification we shall refer to the two principal claims as Susquehanna's (a) "purchase" and (b) "sale" of its own shares. The "purchase" was the acquisition of 222,407 shares from the Kansas City group in exchange for the block of Vanadium stock, and the "sale" was the issuance of 1,274,734 new shares to the former Gypsum shareholders at the time of the merger.

Also for identification purposes, we may list the additional claims which merit discussion as (1) the claim that the Lanman defendants received a premium for selling control of Susquehanna to Korholz; (2) a claim that § 10(b) and Rule 10b-5 were violated by failure to disclose the contemplated transfer of control before it took place; (3) a claim that the Lanman directors did not adequately investigate the qualifications of Korholz to be an officer and director of Susquehanna before his election; (4) a claim that the court should appoint a disinterested arbiter to redetermine the merger exchange ratio; and (5) a claim that deficiencies in the premerger proxy statement require that the merger be set aside.

We turn to the two claims for damages.

A. *Susquehanna's "purchase" of its own stock.*

Federal jurisdiction was properly invoked in this case because the complaint alleged violations of three federal statutes.[27] Of these three, it is § 10(b) of the Securities Exchange Act of 1934, and more particularly Rule 10b-5, that has most direct relevance to the claim that Susquehanna was damaged by paying too much in connection with the purchase of its own shares from members of the Kansas City group in August of 1965. The Rule plainly affords protection to both sellers and prchasers.[28] A private party

[27] See footnotes 1, 2 and 3, *supra*.

[28] *Supt. of Ins. v. Bankers Life & Cas. Co.*, 40 U.S.L.W. 4001, 4002 (Nov. 8, 1971); *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 463 (2nd Cir. 1952). Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the state-

injured by a violation of the Rule may either rescind his purchase or sale or recover his damages in an action at law.[29] It seems clear that a jury trial is appropriate in such a damage action.[30]

In this case there is no doubt that Susquehanna's acquisition of its own shares in exchange for its block of Vanadium stock was a "purchase" within the meaning of the Rule. Plaintiffs contend that as a direct consequence of fraud or deceit proscribed by the Rule, the purchase was made at a price which was unfair to Susquehanna.[31]

The perpetrators of the alleged fraud included several of the directors of Susquehanna. Since the challenged transaction did not require shareholder approval, the directors would normally speak for the corporation in connection with the matter. To the extent that the directors were competent to act for the corporation, it therefore would follow that Susquehanna was the victim of its own fraud.

This theoretical dilemma has been met in other cases by recognizing that defendant directors may deceive disinterested members of the board, and through them the cor-

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[28] (Continued)

ments made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."
17 CFR § 240.10b-5 (1971).

[29] The Supreme Court has clearly indicated that its holding in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, encompasses an action for damages. See *Bivens* v. *Six Unknown Federal Narcotics Agents*, 403 U.S. 388, 397. Note also the comment by Mr. Justice Harlan in his concurring opinion at p. 402:

"Thus, in suits for damages based on violations of federal statutes lacking any express authorization of a damage remedy, this Court has authorized such relief where, in its view, damages are necessary to effectuate the congressional policy underpinning the substantive provisions of the statute. *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964); . . ."

[30] See, *e.g.*, *Myzel* v. *Fields*, 386 F.2d 718, 740-741 (8th Cir. 1967), *cert. denied*, 390 U.S. 951; *Esplin* v. *Hirschi*, 402 F.2d 94, 95 (10th Cir. 1968), *cert. denied*, 394 U.S. 928. See also *Dairy Queen, Inc.* v. *Wood*, 369 U.S. 469, 477-479.

[31] The price paid for the Susquehanna shares may, of course, properly be measured by the value of the consideration delivered to the seller by the purchaser. See *Mueller* v. *Korholz*, 449 F.2d 82, 86, 88 (7th Cir. 1971).

poration.[32] Plaintiffs relied on that theory in the presentation of their evidence and in their argument here. However, a different theory is embodied in the complaint.

The complaint alleges that the entire board was interested in the transaction and, therefore, was not competent to authorize the purchase by the corporation. Accordingly, it is contended that defendants were under a duty to make full disclosure of their adverse personal interests to the shareholders, and that the failure to make that disclosure, or to advise the shareholders that the exchange actually cost Susquehanna $682,500, constituted a fraud or deceit prohibited by Rule 10b-5. The sufficiency of that claim is established as the law of this case, see 380 F.2d 262 at 269-270, and we are satisfied that insofar as a damage recovery is sought, the allegations raise issues triable to a jury.

It does not necessarily follow that the case should be remanded for a new trial on those issues. For if the evidence which plaintiffs adduced at the trial before the court was not sufficient to prove a *prima facie* case, the denial of a jury trial was harmless error. We shall, therefore, consider whether the record contains evidence tending to prove that Susquehanna was deceived, that there was a causal connection between the deception and the purchase, and that it was damaged thereby.

Although the trial judge, after weighing the evidence, rejected the inferences which plaintiffs draw from the facts, we cannot say that either of defendants' versions of the transaction is so clearly correct that plaintiffs' proof failed as a matter of law. Defendants contend that the block of Vanadium stock had no greater value to Susquehanna than the current market because the shares could not be voted while owned by Susquehanna and that, in any event, the benefits received by Susquehanna from the settlement of the pending litigation with Vanadium and the elimination of potential dissension within Susquehanna's top management more than offset the premium value of the Vanadium stock (and thus the true over-the-market cost of the purchased Susquehanna shares). If either of these factual propositions is correct, the purchase did not injure Susque-

[32] *Ruckle* v. *Roto American Corp.*, 339 F.2d 24 (2nd Cir. 1964). See also *Supt. of Ins.* v. *Bankers Life & Cas. Co.*, 40 U.S.L.W. 4001, 4002-3 (Nov. 8, 1971).

lianna and the damage action must fail. But there is certainly evidence in the record from which a jury could conclude that Susquehanna could have realized a premium—possibly the full $682,500[33]—on a sale of the Vanadium stock to a third party or to Vanadium itself, and further, that making peace with the Kansas City group did not necessarily produce a corporate benefit of comparable value. The evidence on the damage issue is, therefore, sufficient for submission to a jury.

There is also evidence tending to prove that material facts were not disclosed to Susquehanna (either to the shareholders or to all of the directors voting on the matter), and that the purchase might not have been consummated on the same terms if full disclosure had been made.

If plaintiffs' version of the transaction is correct, the purchase resulted in a net injury to Susquehanna of approximately $682,500. Neither this fact nor the fact that a threat of litigation was avoided by making the exchange was ever disclosed to the shareholders. Such nondisclosure would not violate Rule 10b-5, however, if a disinterested majority of the board of directors was fully informed about all relevant facts, and if in the good faith exercise of their business judgment they concluded that the transaction was in the best interests of the corporation.[34] For on that hypothesis, since a disinterested majority of the board would have the authority to consummate the transaction, the disclosures within the board would constitute disclosure to the corporation.

A violation of Rule 10b-5 did result, however, if either of two factual propositions is established by the evidence. First, if material facts were misrepresented or withheld from some members of the board of directors, the corporation was deceived. *Rackle v. Roto American Corporation*, 339 F.2d 24 (2nd Cir. 1964). Second, if the entire board of directors was interested in the transaction, a duty of disclo-

[33] The actual damages need not be the full $682,500. If Susquehanna itself could have sold only for a lesser premium, that lesser premium would be the measure of damages. Or, if the jury valued the benefits received as greater than the market value of the Susquehanna shares but less than the full value of the Vanadium shares sold, the difference would be the damage recoverable.

[34] *Kors v. Carey*, 158 A.2d 136, 139, 141 (Del. 1960); *Warshaw v. Calhoun*, 221 A.2d 487 (Del. 1966).

evidence of fraud or deception was thus sufficient to raise an issue for the jury.

Finally, we are persuaded that if the jury should accept plaintiffs' appraisal of the true impact of the transaction on Susquehanna, and if it should conclude that some of the directors were misled by Korholz, it would also be entitled to find a causal connection between the fraud and the injury. We, therefore, hold that plaintiffs are entitled to have a jury decide the issues raised by their claim that the purchase of 222,107 of its shares from the Kansas City group in July of 1965 resulted in damage, possibly as much as $682,500, to Susquehanna.

B. *Susquehanna's "sale" of its own shares.*

From Susquehanna's point of view, the statutory merger involved a sale of 1,274,734 of its own shares, and a purchase of 2,421,996 shares of Gypsum. *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 467-468; *Dasho* v. *Susquehanna Corp.*, 380 F.2d 262, at 268-269, *cert. denied*, 389 U.S. 977; *Swanson* v. *American Consumer Industries, Inc.*, 415 F.2d 1326, 1330 (7th Cir. 1969). Since interstate facilities were employed to consummate the exchange, the merger was a "securities transaction" covered by Rule 10b-5.

If it was the product of fraud or deception proscribed by the Rule, and if Susquehanna thereby suffered a pecuniary injury, a cause of action for damages may be prosecuted by plaintiffs on behalf of the corporation. Under *Ross* v. *Bernhard*, we believe such a claim would be triable to a jury. Before analyzing other elements of the claim, it is appropriate to consider the damage issue; unless the

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[37] (Continued)

asked him "whether he wanted to make some money on his investment or whether he just wanted to raise hell." (Tr. 447) And further, "[F]irst of all, get rid of this letter [threatening litigation] and then I will do it, we can work quietly on some program that gets you what you want as long as it is within reason and gets me what I want for the company." (Tr. 451) Following the July 15 meeting, Korholz accompanied Coen to New York and introduced him to Harder, a Vanadium director and a vice president of International Mining Co. which held substantial Vanadium stock. The purpose of the introduction was to help Coen sell the 140,000 shares. (Tr. 524-525) This evidence may not prove wrongdoing on the part of Korholz, but, taken with other evidence, could provide a basis for a jury to conclude that Korholz had deceived other members of the board.

record contains evidence on which an award of damages could be based, a jury trial may be unnecessary and our review may be limited to determining whether the district court findings on the issue of liability are clearly erroneous.

We find nothing in the record to suggest that Susquehanna should not have been merged with a profitable corporation in order to take full advantage of its tax loss. Nor do we find any evidence indicating that Gypsum was not an appropriate component of such a merged enterprise, or that a more favorable opportunity was lost because of the Gypsum merger. Thus, neither the fact that the merger took place, nor the fact that it was Gypsum that was merged into Susquehanna, appears to have caused any injury to Susquehanna.

Nevertheless, it is possible that the terms of the merger may have damaged Susquehanna. Even if it was wise to sell its shares to obtain Gypsum's earnings, Susquehanna may have been fraudulently induced to accept an inadequate price per share and therefore to issue too many shares.

For purposes of analysis we may assume that Susquehanna sold its own shares for a price of $10.75 per share and purchased Gypsum shares for a price of $5.65 per share. If either the former price was too low, or the latter price was too high, and if no compensating adjustment in the other is appropriate, Susquehanna was damaged. In other words, if the exchange ratio was unfair to Susquehanna, it was injured by the merger.

The district court found that the exchange ratio was fair. All the directors so testified, and plaintiffs offered no expert testimony to the contrary. The finding is further supported by the opinions of New York Hanseatic Corporation and Stone and Webster. Even though the finding is not clearly erroneous, indeed even if we would enter the same finding ourselves, it does not follow that the record contains no evidence from which a jury might have come to a different conclusion.

If the jury could properly find that Susquehanna's approval of the terms of the merger was obtained by fraud, and that a full disclosure of all material facts

would have required an adjustment of those terms in order to obtain the necessary authorization to consummate the transaction, the conclusion that the corporation was in fact damaged by the fraud would be supportable. Assuming the existence of a violation and consequent injury, the question would then be whether the record contains any evidentiary basis for a reasonable calculation of the amount of that pecuniary injury.

Of course, damages may not be the product of pure conjecture or speculation. See *Bigelow* v. *RKO Radio Pictures*, 327 U.S. 251, 264. A jury cannot be permitted to make a random selection of any exchange ratio that might appeal to it. But if we assume that all other elements of the claim, except the amount of damages, have been adequately established, the same standards that juries employ to determine comparable issues in other complex commercial litigation would permit recovery here if the evidence provides a reasonable basis for measuring the injury. On that assumption, we have concluded that the record does contain evidence from which a jury could select an acceptable measure of damages.

It is not inconceivable that arm's length bargaining between fully informed representatives of Gypsum and Susquehanna would have produced an exchange ratio predicated on comparative market values during the months immediately preceding Gypsum's $6,450,000 investment in Susquehanna.[38] For each of the four months prior to May of 1965 such an approach would have produced a more favorable ratio for Susquehanna than 1.9 to 1. Viewing the transaction broadly, if, for example, the ratio of 2.02 to 1 or 1.96 to 1 had been used instead of 1.9 to 1, it could not be said that the total price paid by Susquehanna to acquire Gypsum's assets and earnings was beyond a tolerable range of fairness.[39] For on a 2 to

[38] Following that investment; the value of Gypsum, relative to the value of Susquehanna, improved. If there was any causal connection between the investment and that relative change, it would suggest that Susquehanna, rather than Gypsum, was undervalued. For this purpose we assume that May should be considered the month in which Gypsum made its investment since Korholz was acting in its behalf.

[39] Thus, if such a "fair" ratio, rather than the actual ratio, also "fair" in abstract terms, would have been the ratio chosen by arm's length bargaining of fully informed parties, then such other ratio might be relevant in the computation of damages.

1 basis, assuming with the experts that Susquehanna's shares were worth only $10.75 apiece, it would have paid an aggregate price of approximately $13,000,000[40] for earnings of $814,000, as audited (or $1,374,000, as adjusted) and net assets of $3,984,000.[41]

We by no means suggest that this is the proper measure of damages in this case. Nor do we imply that market values are a better determinant of exchange ratios than expert appraisals. We merely hold that they provide a permissible measure damages from which a jury may estimate the amount of pecuniary damages which a defrauded party has suffered. We, therefore, conclude that if the record contains evidence tending to prove the other elements of plaintiffs' cause of action predicated on the merger, the claim for damages may be submitted to a jury. We now consider those other elements.

Plaintiffs must, of course, prove a violation of law by the defendants and a causal connection between the violation and an injury to Susquehanna. Plaintiffs have argued that there were several deficiencies in the proxy solicitation which violated SEC Rule 14a-9, implementing § 14(a) of the 1934 Act, and that the causation issue is settled by *Mills* v. *Electric Auto-Lite*, 396 U.S. 375. We are convinced that at least one of their attacks on the proxy statement raises a triable issue of fact, but we are not sure that *Mills* disposes of the causation issue in an action for damages. We first consider the violation.

The relevant language of Rule 14a-9 is similar to that found in Rule 10b-5[42] and § 29(a). The proxy solicitation was unlawful if it contained "any statement which . . . is false or misleading with respect to any material fact, or which omits to state any material fact necessary in

[40] If Gypsum's 2,421,996 shares had been acquired on a 2 for 1 basis, Susquehanna would have issued 1,210,998 shares. At the price of $10.75 per share, the aggregate issue would have been worth $13,018,228.50. At the same price, the number actually issued on the 1.9 to 1 basis (1,274,734) was worth approximately $685,000 more.

[41] The figure of stockholder's equity used in the New York Hanseatic report.

[42] Both Rule 10b-5 and Rule 14a-9 apply to proxy solicitations in connection with a purchase or sale of a security. See *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 468; *Swanson* v. *American Consumer Industries, Inc.*, 415 F.2d 1326, 1331 (7th Cir. 1969).

order to make the statements therein not false or misleading. . . ." If a jury should agree with plaintiffs' version of the transaction in August 1965 (when Susquehanna used its block of Vanadium stock to purchase 222,107 of its own shares), it could also properly conclude that the description of that transaction in the proxy statement was misleading.[43] If plaintiffs' analysis is correct, the proxy statement falsely advised the shareholders that a purchase by Susquehanna of approximately $3,000,000 worth of its own shares had been made on a "market to market" basis when in fact a premium of $682,500, amounting to about $3 per share, was paid. The magnitude of the transaction, the fact that it related directly to the value of Susquehanna shares (and therefore to the fairness of the bargain which was the subject of the proxy statement), and the character of the omission or misstatement, all satisfy the test of materiality as stated by the Second Circuit in *General Time Corporation* v. *Talley Industries, Inc.*[44] To the extent that intent is relevant, the evidence is adequate.[45] Plainly, then, there was sufficient evidence of a violation to be submitted to a jury.

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[43] Indeed, even if it should accept defendants' second version of the transaction and determine that the directors' "informed business judgment" included knowledge that a substantial premium was being made available to the Kansas City group, the proxy statement would be misleading because that information was not disclosed to the shareholders.

[44] "The test, we suppose, is whether, taking a properly realistic view, there is a substantial likelihood that the misstatement or omission may have led a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course." 403 F.2d 159 at 162 (1968), *cert. denied*, 393 U.S. 1026. Since plaintiffs circulated a letter to the Susquehanna shareholders urging them to vote against the merger, we believe the comparative approach suggested by the Second Circuit as appropriate for proxy contests is also appropriate here.

[45] The "scienter" required in common law fraud is not necessary. "[K]nowledge of the falsity or misleading character of a statement and a bad faith intent to mislead or misrepresent are not required to prove a violation of the statute upon which a civil remedy for damages will lie." *Kohler* v. *Kohler Co.*, 319 F.2d 634, 637 (7th Cir. 1963).

See also *S.E.C.* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 854-855 (2d Cir. 1968), *cert. denied*, 394 U.S. 976, in which the court indicates that "lack of diligence, constructive fraud, or unreasonable or negligent conduct" may meet the state of mind requirement. *Id.* at 855. These cases discussed the required mental state in a 10(b)-5 case. The same requirements apply in a 14(a) proxy statement case. See *Butler Aviation Intern'l, Inc.* v. *Comprehensive Designers, Inc.*, 307 F.Supp. 910, 914 (D.C.N.Y. 1969), *aff'd*, 425 F.2d 842 (2d Cir. 1970); *Gerstle* v. *Gamble-*

On the question of causation, there is no doubt that the proxy solicitation was an essential link in the accomplishment of the merger. Apart from the solicitation, there is no contention that defendants could have mustered the necessary two-thirds vote required for the approval of the merger. The following language in the *Mills* opinion may, therefore, determine the causation issue:

> "Where the misstatement or omission in a proxy statement has been shown to be 'material,' as it was found to be here, that determination itself indubitably embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote. This requirement that the defect have a significant *propensity* to affect the voting process is found in the express terms of Rule 14a-9, and it adequately serves the purpose of ensuring that a cause of action cannot be established by proof of a defect so trivial, or so unrelated to the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interests protected by § 14(a).
>
> "There is no need to supplement this requirement, as did the Court of Appeals, with a requirement of proof of whether the defect actually had a decisive effect on the voting. Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction." 396 U.S. at 384-385.

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[45] (Continued)

Skogmo, Inc., 298 F.Supp. 66, 97 (D.C.N.Y. 1969) (even less "scienter" than required in a Rule 10(b)-5 case is required in a §14(a) case).

We feel it unnecessary to discuss the evidence in this case on the requisite mental state except to say that the evidence appears sufficient to warrant a jury finding that the requisite mental state existed. We note, of course, that if plaintiffs prevail on the intracorporate deception theory, then there may be some defendants who did not have the requisite state of mind.

There are two reasons why quotation of that language out of its context does not necessarily eliminate the causation issue in this case. In *Mills* the plaintiffs were seeking equitable relief, not damages as plaintiffs do here. In *Mills,* apart from any question of the fairness of the exchange ratio, plaintiffs sought to vindicate their right to be shareholders of a separate company rather than a larger, combined enterprise[46]; here the merger itself was apparently unobjectionable[47] and a damage award must, in effect, depend on a revision of the exchange ratio. Thus, although the *Mills* holding would seem to require a finding of "legal injury" caused by the violation, in this case that injury may not include any pecuniary loss.[48]

In short, we think *Mills* takes us this far: If plaintiffs prevail on the issue of materiality, they have also established that approval of the 1.9 to 1 exchange ratio was unlawfully obtained. But that approval caused Susquehanna monetary injury only if (a) Susquehanna would have been better off with no merger at all; or (b) a more favorable exchange ratio would have been available if there had been full disclosure. The first alternative is not supported by any evidence which has been called to our attention; the second requires an evaluation of the transaction from Gypsum's point of view as well as Susque-

[46] See the portion of footnote 5 appearing on page 383 of 396 U.S.

[47] In the letter which plaintiffs mailed to the Susquehanna stockholders urging a vote against the merger, they stated, in part:

"We take no position here as to whether a merger between Susquehanna and American Gypsum is desirable. We do, however, take the position that based upon the information presently available to stockholders, the terms proposed seem grossly unfair to Susquehanna. *We, therefore, urge that you do not approve the merger on its present terms.*" (Emphasis in original.) DX-68, p. 3.

[48] We identified two different kinds of legal injury in *Swanson, supra*:

"Defendants next assert that no injury can be shown because any corporate opportunities or going concern value of which the Peoria shareholders might have been deprived is retained by them by virtue of their continuing equity position in ACI. The short answer is that if the allegations of the complaint are proved, the Peoria shareholders were entitled to a more favorable exchange ratio than they were granted and may have had their equity position unfairly diluted. Moreover, as recognized by the Supreme Court in SEC v. National Securities, Inc., 393 U.S. 453, 467, 89 S.Ct. 564, 21 L.Ed. 2d 668, the fraudulent substitution of shareholder status in one company for the same status in another may constitute a cognizable legal injury in and of itself." 415 F.2d at 1332.

hanna's. For if it were plain from the record that Gypsum's shareholders would not in any event have approved a merger on terms which required surrender of more than 1.9 of their shares for each Susquehanna share, then approval of those terms, even if unlawfully obtained, did not harm Susquehanna.

Plaintiffs argue that Gypsum was under significant economic pressure to effect the merger because of its heavy indebtedness and its commitment to repay the $6,450,000 bank loan promptly after the completion of the merger. They contend, therefore, that arm's length bargaining would have produced a more favorable ratio for Susquehanna without precluding the likelihood that Gypsum's shareholders would have approved of the merger on different terms. The district court found this argument unpersuasive, but we cannot say that it is so lacking in evidentiary support that it does not warrant consideration by the trier of fact.

Accordingly, we conclude that there is evidence in the record from which a jury might find (1) that material facts were misstated or omitted from the proxy materials in violation of federal law; (2) that the violation caused the shareholders of Susquehanna to approve the merger on the terms submitted; (3) that terms which would have been more favorable to Susquehanna might have been sufficiently attractive to the Gypsum shareholders to make it reasonable to conclude that they would have given their approval to different terms; and (4) that the record contains relevant data from which a jury might make a just and reasonable estimate of the amount of Susquehanna's damage. We, therefore, hold that plaintiffs are entitled to have a jury decide the issues raised in their claim for damages predicated on the merger.

IV.

In our opinion, plaintiffs' remaining claims are all equitable in character. Two relate to the merger and three to Korholz's original purchase in May.

With respect to the merger, plaintiffs prayed that it either be set aside or that an independent arbiter be

appointed to redetermine the exchange ratio. The record makes it quite clear that neither of these forms of relief would be feasible or appropriate. The merger itself (as opposed to its terms) does not appear to have harmed Susquehanna or its shareholders, and it is far too late to permit an arbiter to remake the bargain which the minority shareholders of Gypsum accepted.

With respect to the sale of 430,000 shares to Korholz, plaintiffs advance three theories of recovery, each of which is predicated on a version of the transaction which the district court rejected. Plaintiffs argue that certain findings with respect to the alleged transfer of control from Lannan and his associates to Korholz are clearly erroneous, or at least could be shown to be erroneous if admissible evidence had not been improperly excluded. For purposes of considering these claims, we assume, without deciding, that the evidence should have been received and that plaintiffs' version of the transaction is essentially correct.

They contend that Korholz's payment of $6,450,000 was not merely a purchase of shares but included the payment of a premium of about $1,075,000 to obtain working control of Susquehanna. He would not have paid that price unless he had been sure of adequate representation on the board, including election as its chairman. After his election, his position, coupled with his stock ownership, enabled him to exercise "working control" of the corporation. Assuming these facts as proved, we consider plaintiffs' three theories of recovery.

A. First, relying on *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2nd Cir. 1968), *cert. denied*, 394 U.S. 976, plaintiffs contend that Rule 10b-5 was violated when the Lannan directors sold their shares on the basis of "material inside information" which they possessed and which they had a duty to disclose to the public. The inside information was the fact that Korholz had offered to pay them $15 per share for a block of 430,000 shares.

We would agree that if the directors, having knowledge of such an offer, had purchased shares at a lower price on the open market in order to assemble a block to be sold to Korholz at the premium price, those purchases

on the open market would be securities transactions covered by Rule 10b-5. We find no evidence of any such purchases; nor is there any evidence that the plaintiffs, or any member of the class they represent, engaged in any purchase or sale of Susquehanna stock which would have been more favorable if the Korholz offer had been disclosed before his purchase from Lannan was consummated, or that anyone failed to engage in any favorable transaction as a result of the nondisclosure.

We do not believe Rule 10b-5 imposes an obligation on controlling shareholders to make prompt disclosure of every offer they receive[49], and find no evidence that an earlier disclosure of the Korholz offer would have benefitted plaintiffs in any way. We, therefore, conclude that the district court correctly rejected plaintiffs' first contention.

B. Plaintiffs also contend that the Lannan directors did not make an adequate investigation of Korholz before electing him to the board. They argue that a full investigation would have revealed that he was purchasing the stock on behalf of Gypsum, that he was already planning a merger, and that as a consequence of the merger Susquehanna would provide the funds which were used to pay $6,450,000 to the Lannan group.

To the extent that this argument is advanced to support the prayer that Korholz's election as a director should

[49] "An insider's duty to disclose information or his duty to abstain from dealing in his company's securities arises only in 'those situations which are essentially extraordinary in nature and which are reasonably certain to have a substantial effect on the market price of the security if [the extraordinary situation is] disclosed.' Fleischer, Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding, 51 Va.L.Rev. 1271, 1289." *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2nd Cir. 1968), *cert. denied*, 394 U.S. 976.

"The essence of the Rule is that anyone who, trading for his own account in the securities of a corporation has 'access, directly or indirectly, to *information intended to be available only for a corporate purpose* and not for the personal benefit of anyone' may not take 'advantage of such information knowing it is unavailable to those with whom he is dealing,' i.e., the investing public. Matter of Cady, Roberts & Co., 40 S.E.C. 907, 912 (1961)" *Id.* (emphasis added.)

The information which some of the directors had — that Korholz was willing to pay $15 a share for 430,000 shares of Susquehanna stock — was not "information intended to be available only for a corporate purpose."

be declared null and void, it is foreclosed by findings of fact to the effect that adequate investigation of his character, reputation, and experience was made. Those findings are supported by the record.

To the extent that the argument relates to the consequences of the merger, we believe it is subsumed by plaintiffs' second damage claim. If neither the merger itself nor its terms damaged Susquehanna, the fact that assets of the merged enterprise were used to discharge a liability of the merged enterprise certainly did not damage either of its components.

C. Finally, in their reply brief plaintiffs have directed our attention to *Keeley* v. *Black*, 107 A. 825 (N.J. Ch. 1919), and certain other state cases to support the suggestion that the premium received by a director in connection with the sale of a controlling block of stock should be treated as an asset of the corporation. The rule of that case is not a matter of federal law or, so far as we have been advised, the law of the state in which either Susquehanna or Gypsum was incorporated. Even if Lannan's shares constituted control of Susquehanna, we believe he had a right to sell them for a premium price. See *Essex Universal Corp.* v. *Yates*, 305 F.2d 572 (2nd Cir. 1962).

Defendants Lannan, Lauhoff and Schmick are not responsible for actions taken by other defendants or by the board of directors after their respective resignations. The death of defendant Michels has been suggested of record. Accordingly, insofar as the district court judgment dismissed the claims against Lannan, Lauhoff, Schmick and Michels, it is affirmed. As to the other defendants, the judgment is reversed and the case is remanded for a jury trial.